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NOTES & COMMENTS.

PROGRESS OF THE LAW OF INCOME TAX IN THE YEAR 1936.

On the subject of ACCOUNTING the decision of the Bombay High Court in *Sarupchand* v. *Commissioner of Income Tax, Bombay*, (1936 I.T.R. 420) establishes that an assessee is entitled to change the method of accounting regularly employed by him and that if the regular method has been changed in fact, the income tax authorities are bound to recognise the change in method; but, as the learned Judges have pointed out in this case, what the assessee must alter is his regular method, that is to say, he must abandon what, up to that time, had been his regular method and start a new regular method and not merely a new method for a casual period. Further, the question whether a regular method of accounting has been changed is a question of fact upon which Commissioner's finding is final. Another decision of the Bombay High Court reported as *Commissioner of Income Tax, Bombay* v. *Abubaker Abdul Rahman* (1936 I.T.R. 233) shows that where an assessee has two businesses with different accounting periods he cannot fix two different dates which will give him two separate previous years for the purpose of the Income-Tax Act, but he can fix one date for himself and another date for a firm of which he is a member; and if the date which the assessee has fixed for himself is earlier than the date which the firm has fixed, the assessee cannot be compelled to include in the return of his total income his share in the profits of the firm which were ascertained after the expiry of the accounting year which the assessee has fixed for himself. The third decision which may be referred to on this subject is that of the Lahore High Court in *Malamal Shibdayal* v. *Commissioner of Income Tax, Punjab*, (1936 I.T.R. 206) which lays down that an assessee need not necessarily adopt the financial year as the accounting period or adopt a method which would avoid two dates of 31st March falling within one accounting period. The *sambat*

year may be adopted even though its length is not constant and sometimes it extends over two dates of 31st March.

As regards AGRICULTURAL INCOME, lambardari fees and income derived from commission received by a landlord from tenants for selling their produce have been held to be not agricultural income in *H. T. Conville* v. *Commissioner of Income Tax, Punjab* (1936 I.T.R. 137). In an English case *Peterborough Royal Foxhound Show Society* v. *Inland Revenue Commissioners* (1936 I.T.R. Eng. Cas. 18) it has been held that a society formed to promote foxhound breeding is an agricultural society within the meaning of that expression as defined in the English Income Tax Act. *Dharat*, that is weighing charges levied by a landlord in addition to rent under agreements entered into with the tenants, have been held to be agricultural income in the *Probynabad Stud Farm Case* (1936 I.T.R. 114).

On the question whether co-owners constitute an ASSOCIATION OF INDIVIDUALS and are liable to be assessed as such, the law has undergone a slight change. The view expounded by the Calcutta High Court in *In re Elias* (1935 I.T.R. 408) that co-owners can be assessed as an association if they have joined together for a common purpose does not coincide with the view expressed in *Mohammad Aslam's case* (1936 I.T.R. 412) in which the Allahabad High Court has laid down that before there can be an 'association of individuals' within the meaning of Section 3 it must first be shown that the association has at least some of the attributes of a firm of partnership and that persons having specified but undivided shares in property which produces income do not come within the expression association of individuals and are not liable to be assessed to income tax as such. The Allahabad High Court has further held in this case that even the appointment by the co-owners of a common collecting agent will not convert such a body of co-owners into an association of individuals. It is obvious that so long as a number of persons own undivided shares in a property they will have to join in some common purpose or other and the test laid down by the Calcutta High Court is not quite sound, as we have already observed in commenting upon that case.

The law relating to BAD DEBTS is still in an unsettled state and on the question when a debt becomes bad and whether it has become bad, assessees are still at the mercy of the income tax authorities. The entirely conflicting conclusions which the income tax authorities come to on the same facts and in the same case show that the correct principle to be applied has not yet been clearly realised. The cases of *Harnand Rai Harbhagat*

Rai (1936 I.T.R. 366), *Hukam Chand Jagadhar Mal* (1936 I.T.R. 380) and *Som Chand Maluk Chand* (1936 I.T.R. 382) may be referred to in this connection. The last case, however, lays down that the creditor is not bound to strike off a debt as a bad debt as soon as he finds that his debtor is in difficulties.

Coming to best JUDGMENT ASSESSMENT the cases of *Banarsi Das* (1936 I.T.R. 142) and *Bhiwani Shahai Bishambar Dayal* (1936 I.T.R. 222) may be noted. In the first case it was held that even a partial default in the production of account books would entitle an income-tax officer to make a best judgment assessment and in the second case it was held that income-tax authorities are entitled to require an assessee to produce the accounts of his foreign business for determining the profits in that business and to make a best judgment assessment, on his refusal to produce them.

There has been some important pronouncements on what constitutes BUSINESS EXPENDITURE. In the *Indian Radio and Cable Communications Ltd.* v. *Commissioner of Income Tax, Bombay* (1936 I.T.R. 90) in which a company which took up the business of another company had agreed to pay a share of the profits to the latter, it was held that the amounts paid to the latter company were not allowable as business expenditure in assessing the profits of the former company, following the principle laid down in the *Pondicherry Ry. Co.'s Case* that tax attaches as soon as profits accrue and that the Crown is not concerned with how the profits are subsequently applied by the assessee. This case was followed in *Tata Hydro Electric Agencies, Ltd.* v. *Commissioner of Income Tax, Bombay* (1936 I.T.R. 92). In *Lakshmi Narayan Sen In re*, (1936 I.T.R. 255) it was held that the question whether payments made to directors as remuneration for services are really *bona fide* payments for services and as such allowable as business expenditure, or a mere distribution of profits to evade income-tax or super-tax, is a question of fact which the income-tax authorities are competent to go into and that the High Court would not interfere with their finding. In *Narasingha Chandra Nandi's Case* (1936 I.T.R. 428) it has been laid down that where a person leaves the conduct of his business to a managing agent and allows him to retain the net profits of the business as remuneration, receiving only a certain portion of the profits for himself from the agent, the principal is liable to be assessed on the entire profits and cannot claim a deduction of the share of the profits retained by the agent, as business expenditure. The difference between capital expenditure and business expenditure is also considered in *Hakim Ram*

Prasad, In re (1936 I.T.R. 104). In this case payments made by the owner of a cinema to an electric company for the use of a projector for a period of ten years were held to be business expenditure and not capital expenditure even though there was a big initial payment in the first year. It is pointed out in this case that the mere fact that half the total rent was taken in advance in the first year would not justify a finding that it was a capital payment.

The liability of CHAMBERS OF COMMERCE and other trade associations to be assessed to income tax and the method of assessing them are considered in the *Chamber of Commerce, Hapur* v. *Commissioner of Income Tax, U.P.* (1936 I.T.R. 397). This case lays down (i) that such an association is not exempt from being assessed to income-tax merely because it is an association not formed for making profit and is registered as a company under Section 26 of the Companies Act, and (ii) that a chamber of commerce is not a charitable institution within the meaning of the Income Tax Act.

The real nature of CHARITABLE INSTITUTIONS and the meaning of the word 'charitable' are discussed in the case of the *Chamber of Commerce, Hapur* (cited above). This case distinguishes 'charitable institutions' from mutual benefit societies and refers to the principle that though an institution would be one of 'general public utility' even though the benefit goes to a section of the community only, the benefit must be to an appreciably important class of the community; where the benefit is only to some private individuals or a fluctuating body of private individuals the purpose will not be a charitable one. Mutual benefit societies fall within the latter class. Further the learned judges hold in this case, that before an institution can be held to be charitable there must be an element of altruism, that is to say, the beneficiary must not be able to *claim* the benefit. The English case of *Peterborough Royal Foxhound Show Society* v. *Inland Revenue Commissioners* (1936 I.T.R. Eng. Cas. 18) shows that 'a society may be established with an immediate direct but incidental motive or purpose which is not charitable but with an ultimate indirect but main purpose which is charitable and that in that case it would come within the exception, and that the test is therefore the main and dominant though indirect purpose. Lawrence, J., has further held in this case that the question whether a society is established for charitable purposes or not is not a pure question of fact. The result of the decisions on the point, his Lordship says, is that it is for the Commissioner to say what are the purposes of the society and for the Court to decide, as a matter of law, whether those purposes are charitable. We may

also refer before leaving this topic to the *Probynabad Stud Farm Case* (1936 I.T.R. 114) in which a stud farm conducted for supplying remounts to a regiment and improving horse breeding was held not to be a charitable institution.

In the *Bengal Coal Co. Ltd.* v. *Janardan Kishore Lal Singh Deo* (1936 I.T.R. 392) it was held that income-tax levied on the lessor of a COLLIERY in respect of the income of the mines was not a tax charged or assessed upon the mines but was a charge on the lessor's total income and that the lessor was not therefore entitled to claim the same from the lessee, even though there was a clause in the lease making the lessee liable to pay all taxes upon the mines. This case emphasizes the principle that income-tax is a tax on the income and not on the property yielding the income and that it is one tax and not a collection of taxes.

(*To be continued*).

SUCCESSION TO BUSINESS.

GREGORY & CO.'S CASE (1937 I.T.R. 12).

Under Section 26 (1) of the Income Tax Act if it is found at the time of assessment that a change has occurred in the constitution of a firm or a new firm has been constituted the assessment on the firm has to be made as if the firm had been constituted throughout the previous year as it was constituted at the time of the assessment; and under sub-section (2) if it is found at the time of assessment that a person carrying on any business has been succeeded by another person, assessment shall be made on the successor as if he had been carrying on the business throughout the previous year and had received the whole of the profits of that year. The case of *Messrs. G. I. M. Gregory & Co. In re* (1937 I.T.R.12) shows that the question whether there has been a change in the constitution of a firm or a firm has been newly constituted within the meaning of sub-section (1) and the question whether there has been succession to a business within the meaning of sub-section (2) are very difficult to answer. In *Gregory & Co.'s Case* a jute business was being carried on under the name of Messrs. G.I.M. Gregory & Co. Mr. Gregory was the active partner in the firm and he changed his capitalist partner each year by entering into new agreements which were to last for one year from July to July. The business however was carried on throughout under the same firm name, namely, G.I.M. Gregory & Co., the same trade mark was used and each successive partnership obtained all the

advantages of the goodwill of the preceding year's partnership. The question arose whether in the assessment year 1932-33 the firm of G.I.M. Gregory & Co., as constituted under the agreement of July, 1931, could be assessed in respect of the profits made by the firm as constituted under the agreement of July, 1930, either under Section 26 (1) or under Section 26 (2).

The CHIEF JUSTICE was of opinion that neither sub-section (1) nor sub-section (2) was applicable to the case. In his Lordship's opinion in each year there was a different firm, one did not succeed to another and each firm was liable to be taxed only in respect of the profits made by it. COSTELLO, J., and PANCKRIDGE, J., were of opinion that assessment could be made in the year 1932-33 on the profits made by the firm as constituted in the previous year, but the grounds on which their Lordships have based their decision are different. COSTELLO, J., is of opinion that there was throughout a firm which went on continuously year after year carrying on the business and whenever Mr. Gregory entered into an agreement with a new partner there was merely a change in the constitution of that firm within the meaning of Section 26 (1). Though his Lordship was also inclined to accept the view that there was a succession and the case was covered by sub-section (2), he has expressly refrained from basing his decision on the point of succession. In PANCKRIDGE, J.'s opinion the case was really one of succession and was covered by Section 26 (2). In his view Section 26 (1) was not applicable to the case at all. That sub section applies only when a change occurs or a firm is newly constituted during the currency of the partnership. There is thus a clear conflict of opinion on the interpretation of sub-sections (1) and (2) of Section 26. We think both from a business and a legal point of view COSTELLO, J.'s opinion is to be preferred.

The following points relating to succession may be gathered from the judgment in this case and the authorities cited therein:

(1) Succession does not include the accidental acquisition by a trader who continues in business, of the custom left by another who goes out of the business.

(2) Succession does cover any case of transfer by one trader to another of the right to that benefit which arises from connection and reputation.

(3) The question whether there is in any particular case a succession or not is a question of fact, though the question whether a particular set of facts amount to succession within the meaning of Section 26 (2) is a question of law.

(4) In order to constitute succession it is not necessary that any tangible assets should pass from the preceding to the succeeding firm.

(5) A document of transfer is not necessary to constitute succession. Succession depends on the continuity of the business carried on by the successor and the predecessor.

(6) The rule that there cannot be succession to a part of a business does not imply that if what is succeeded to is not the same extent of trade or even does not include a particular line or set of customers there cannot be a succession to the trade or business.

Assessment of Income of Impartible Estates: Raja of Bobbili's Case.

The question whether the holder of an impartible estate is to be assessed in respect of the income of the estate as an individual or as the representative of a Hindu undivided family was recently referred to the Madras High Court in *Raja of Bobbili's Case* and after a careful consideration of the rulings of the Judicial Committee and the High Courts of India on the nature of impartible estates and the rights of the holder of the estate for the time being over the income of the estate, a Special Bench of the High Court SIR H. O. C. BEASLEY, C. J., MOCKETT, J. and LAKSHMANA RAO, J.) have decided, in a judgment delivered on December 4, 1936, that the income of an impartible estate belongs absolutely to the holder of the estate for the time being, and that the holder of such an estate is therefore liable to be assessed to income tax and super tax on the income of the estate as an individual and not as the representative of a Hindu undivided family. The judgment will be reported in our next issue.

Business Expenditure: Amounts Paid In Instalments For Exclusive Privilege to Excavate Shells.

It was decided by the Madras High Court in the year 1934 in *Chengalvaroya Mudaliar's Case* (1934 I.T.R. 395) that amounts paid to the Government in consideration of the exclusive privilege of excavating lime shells from Government property for a certain period were in the nature of capital expenditure and cannot be deducted as business expenditure even though the amounts were payable under the agreement, and paid in fact, in several instalments. In a recent case the assessee, in consideration of the grant of the exclusive right of excavating shells from a certain area for three years agreed to pay Rs. 30,450 to the Secretary of State for India in twelve equal instalments. In the agreement there was a recital of 'the annual lease amount being Rs. 10,150,' and the

learned Counsel for the assessee sought to distinguish this case from *Chengalvaroya Mudaliar's case* on the ground that in this case in view of the recital in the agreement the Rs. 30,450 represented three years' annual lease amount or rent and was consequently revenue expenditure. The High Court however held in a judgment delivered on the 4th December 1936, that the addition of these words did not make any material difference and could not alter what was really a capital expenditure into revenue expenditure. This case will also be reported in the next issue.

Blowing Hot and Cold.

The rule that a party is not entitled to blow hot and cold, that is to say, to take up one position at one stage of the proceedings and to take up an inconsistent position at a subsequent stage is often applied in proceedings before Civil Courts. In *Charusila Dasi, In re* (1937 I.T.R. 1) the High Court of Calcutta has applied the rule to income tax proceedings. When a widow was assessed as administratrix of her husband's estate on the income of the estate she contended that certain amount which she had spent for her own maintenance under the provisions of the will could not be treated as income of the estate and her contention was upheld by the Income Tax Department. When the Department sought to include in her personal income the amount which had thus been excluded from the income of the estate she contended that it was not her income. The High Court held that whether the exclusion of this sum from the income of the estate was right or wrong, in view of the attitude which she took up when she was assessed as an administratrix, the widow ought not to be allowed and it did not lie in her mouth to say that the sum which she had declared not to be part of the income of the estate was not her income.

Maintenance Allowances.

The concluding portion of the judgment of the Chief Justice in *Charusila Dasi's Case* suggests that a difference exists between cases where a person is given a sum of money for his maintenance and where a certain sum of money is spent on that person for his board, lodging or maintenance by another person. In the former case the sum would be income of the recipient but in the latter case he cannot be regarded as having received any income.

OURSELVES.

THERE are clear prospects of legislation on income-tax law which may considerably modify the existing law. Several judgments affecting the welfare of millions of citizens are also being pronounced by the Courts, and the new legislation is sure to give rise to more decisions. It is our earnest desire to keep our readers in closer touch with the progress of income-tax law by issuing our reports once every fortnight from the 1st of March and to publish weekly issues if necessary, after the introduction of the new legislation. Our success in this direction, we need hardly say, depends to a great extent on the co-operation and support of our readers.

Income Tax Reports.

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JUDICIAL COMMITTEE ON 'HINDU UNDIVIDED FAMILY'.

Kalyanji Vithaldas's Case.

MEANING OF 'HINDU UNDIVIDED FAMILY'.

The Judicial Committee have pronounced, in *Kalyanji Vithaldas and others* v. *Commissioner of Income Tax, Bengal*, to be shortly reported, a judgment which is of very great importance to Hindu assessees. The judgment was delivered in an appeal preferred by the assessees against the decision of the Calcutta High Court which is reported in 1935 I.T.R. at page 123 as *Mooljee Sicka, In re.* It will be remembered that in that case the Calcutta High Court had held that wherever the term Hindu undivided family was used in the Income Tax Act, a Hindu coparcenary was meant. This proposition was doubted by us in our Notes and Comments and dissented from by the Bombay High Court in *Lakshminarayan's Case* (1935 I.T.R. 367). The judicial Committee have now held that the view taken by the Calcutta High Court is not correct. Their Lordships say:

"The phrase 'Hindu undivided family' is used in the statute with reference not to one school only of Hindu law but to all schools and their Lordships think it a mistake in method to begin by pasting over the wider phrase of the Act the words Hindu coparcenary—all the more that it is not possible to say on the face of the Act that no female can be a member".

THE DECISION.

As we had stated in our Notes and Comments, for deciding *Mooljee Sicka's Case* it was not necessary to go so far as to hold that a Hindu undivided family meant a coparcenary, for the case was one of income from self-acquired property which was not thrown into the joint stock. Neither the existence of a son or sons, nor of a wife or daughter, can make such property joint family property and the income therefrom has therefore to be assessed as the income of the individual to whom it belongs. We said that

Mooljee Sicka's Case could be decided on this ground and the Judicial Committee have upheld the decision on this ground.

FURTHER OBSERVATIONS.

But their Lordships have made some further pronouncements which deserve careful notice. They say that even assuming that the property of a Hindu is ancestral property, that is, property inherited from his father, the mere existence of a wife and a daughter or daughters would not make the property joint family property and that the income from such property has to be assessed as the income of an individual even though the assessee has a wife and daughters. In their Lordships' opinion even though the family in such cases is an undivided Hindu family the property does not belong to that family but to the individual and the income is not therefore the income of the undivided family. They hold that the words 'income of' are capable of a wider or narrower meaning, but for the present purpose courts are concerned with them as they appear in the Income Tax Act and under Section 3 or Section 55 income is not to be attributed to anyone of the five classes of persons mentioned by any loose or extended interpretation of the words but only where the application of the words is warranted by their ordinary legal meaning. In an extra legal sense and even for some purposes of legal theory ancestral property may perhaps be described and usefully described as family property but it does not follow that in the eye of the Hindu law it belongs, save in certain circumstances to the family as distinct from the individual. Their Lordships are of the opinion that it is not in consonance with ordinary notions or with the correct interpretation of the law of Mitakshara to hold that property which a man obtained from his father, belongs to a Hindu Undivided family, by reason of his having a wife and daughters.

SCOPE OF THE DECISION.

It will be obvious from a perusal of the judgment and the reasoning upon which it is based that the above observations are made with reference to cases where property is received by way of gift or inherited by a Hindu. In such cases their Lordships hold that under the Hindu Law the property is not the property of the family even though it may become the property of an undivided family on the birth of a son who acquires an interest in it by birth. Does this reasoning apply to cases where, by

reason of the death of all the male members of a Hindu family except one, the family comes to consist of one male member and other female members? Does property which till then belonged to the Hindu undivided family and the income of which was being assessed as the income of the family become the property of the male member alone? Is there any juridical act or event in such cases which transfers the ownership of the property from the family to the individual and compels or justifies us in treating the income which was till then assessed as the income of the family as the income of the individual? What is the Hindu law on this point? These important questions may have to be argued and decided when a case of this nature arises. The decision of the Judicial Committee does not in terms cover such cases. The view that the undivided family ceases to exist in such cases is now untenable in view of this judgment of the Judicial Committee.

Income of Impartible Estates.

In our January number we had referred to the recent decision of the Madras High Court in *Raja of Bobbili's Case* that the income of the holder of an impartible estate is his absolute property and that it should be assessed as the income of an individual, *viz.*, the holder of the estate for the time being and not as the income of a Hindu undivided family. Their Lordships have proceeded on the basis that it is impossible to take a contrary view in the face of the several rulings of the Judicial Committee which clearly lay down that the income of an impartible estate is the absolute property of the holder. It is worthy of note that in *Kalyanjee Vithaldas's Case* referred to just above the Judicial Committee have adverted to this topic but left it open. Their Lordships say:

"Their Lordships will not here deal with the case of an impartible estate held by the senior of several male members of a family as to which there have been conflicting decisions in India: (cf. *Raja Shiva Prasad Singh* v. *Secretary of State*, 4 Pat. 73, *Kishen Kishore* v. *Commissioner of Income Tax, Punjab*, 14 Lah. 255)."

Allowance of Interest on Capital Borrowed For Business But Subsequently Locked Up in Agricultural Lands.

S. A. S. S. CHELLAPPA CHETTIAR'S CASE

Owing to the economic depression which has been prevailing for some years, bankers and money-lenders have been compelled in

innumerable cases to purchase their debtors' lands by private agreement or in court sale, in repayment of loans advanced by them. Several crores of rupees of Chettiar money-lenders are now lying so locked up in agricultural lands of Burma. The recent decision of the Madras High Court in *S. A. S. S. Chellappa Chettiar's Case* (to be reported shortly) in which, after hearing the arguments of some eminent Counsel, a Special Bench of the Madras High Court [SIR OWEN COMPTON BEASLEY, C. J., MOCKETT J., and LAKSHMANA RAO J.,] have in an elaborate judgment answered in the affirmative the question

'Where a person who is carrying on business as a money-lender borrows money for his money-lending business and lends it out to constituents, and is obliged in the course of business to receive agricultural lands in repayment of his debts from such constituents is he not entitled to a deduction of the interest paid by him on so much of the capital borrowed by him for business purposes as is represented by the agricultural lands got in, under Section 10 (2) (iii) in computing the profits and gains of the banking business'

is sure to be welcomed as a god-send by those who carry on money-lending business.

The Counsel for the Commissioner strenuously argued that as the income from the agricultural lands was itself exempt from income-tax, interest on capital borrowed and invested in the purchase of such lands could not be allowed to be deducted. He contended that the object of Section 10 of the Act in making provision for certain allowances was to reduce the amount of taxable income and that the section could not apply to any income which was not the subject of taxation.

Their Lordships held that the question was whether the conditions of Section 10 (2) (iii) were satisfied. The capital was borrowed, it was borrowed for the purposes of the business and it was used for the business as it was lent to customers. Sec. 10 (2) (iii) was complied with and the borrower was entitled to have the full benefit of the Act. The deduction was further not inequitable inasmuch as tax is levied by the Government on agricultural lands in the form of land revenue. Their Lordships strongly relied on a recent decision of the Court of Appeal of England.

SOME DOUBTS.

To entitle an assessee to the benefit of Section 10 (2) (iii) is it enough if the capital was borrowed and used once upon a time

for the purpose of the business? Does not the expression "capital borrowed for the purposes of the assessee's business" involve the idea that in the year of account in respect of which the allowance is sought the capital must retain its character of capital borrowed for the purposes of the business? Can we say that capital once borrowed for business but subsequently invested in agricultural lands is still capital borrowed for the business? Should we not take it that when the lands are purchased the loan is discharged and there is a fresh investment in lands? Can the fact that the assessee did not enter into the transaction of his own choice and that he would have preferred repayment in cash change the legal nature of the investment? Does not the view that capital so invested in lands is still capital invested in business cut at the root of the distinction between income from business and income from lands which the Judicial Committee have emphasised in the Maharajah of Darbhanga's Case, 1935 I.T.R. 135? These doubts are lurking in our minds, but as the matter is not free from difficulty and there is much to be said in favour of the view now taken by the Madras High Court we can only await with interest a final pronouncement of the Judicial Committee.

Succession to Business: Business Must be Same not Merely Similar.

We had reported in the January number the case of *Messrs. Gregory & Co.* in which there was a discussion by three learned Judges of the Calcutta High Court of what constitutes succession to business. A somewhat similar case came before the Madras High Court in *Kannappa Naicker & Co. In re*, and the judgment delivered in this case by a Special Bench on December 18, 1936, is reported at page 49 *et seq.* below. The High Court has in this case laid stress upon the principle that there can be a succession to business within the meaning of Section 22 (2) of the Indian Income Tax Act only where the *same* business is carried on by a different person and that Section 26 (2) of the Income-tax Act is not therefore applicable to a case where a business terminates and a different though similar business is carried on by another person or a newly constituted firm. The application of this principle to the facts of particular cases is however a matter of very great difficulty, as the case in question itself shows. Two firms had been separately supplying labour to the Madras Port Trust for several years under contracts given to them by the Port Trust from time to time. The last contract with these firms expired on a certain

date. The two firms thereupon formed themselves into a new firm to avoid competition and the new firm supplied labour to the Port Trust from the date on which the prior contracts expired. There were no assets or liabilities to be transferred but the new firm adopted the trade name of one of the old firms and also employed the same employees and carried on business in the same premises. The Commissioner was of opinion that there was a clear case of succession to the business of the old firms. The High Court however held that the business of the old firms terminated on the date on which their contracts expired, that the business of the new firm was a different one though similar in nature to that of the old firms and that the new firm could not therefore be treated as a successor to the old firms and assessed as such. This decision shows that mere continuation of the trade name and goodwill and carrying on business with the same employees and in the same premises is not sufficient to constitute succession to business. It is only where the same business is continued by a different person that there can be succession.

Hindu Undivided Family: Members Continuing Family Business As Firm After Partition: Mode of Assessment.

Instances where the members of a Hindu undivided family carrying on a business, form themselves in a firm after partition and continue the business are of very frequent occurrence. What is the correct procedure to be adopted in making an assessment in such cases? Are the income-tax authorities to proceed under Sec. 25-A of the Income Tax Act and make an assessment as if no separation or partition had taken place, holding each member liable for a share of the tax on the income so assessed proportionate to the portion of the joint family property allotted to him as laid down in Sec. 25-A, or, are they to proceed under Sec. 26 (2) and make an assessment on the firm as the successor of the family and as if it had been carrying on the business throughout the previous year and had received the whole of the profits for that year? This question was recently considered by the Lahore High Court in *Mittachand Lakhmidas* v. *Commissioner of Income Tax, Punjab*, (to be reported in the next issue). The High Court has held that the correct procedure to be adopted in such cases is that laid down in Sec. 26 (2) of the Act. With regard to the scope of Sections 25-A and 26 of the Act the learned Judges say:

"Section 25-A would cover the case of a joint Hindu family in which there has been a disruption and consequent partition but

no continuance of the business either by the members of the joint Hindu family on contractual basis or by some of them alone or jointly with others or even by strangers. Where the business has been discontinued Section 25-A will apply, but where it is continued Section 26 will apply."

Their Lordships further say that it makes no difference whether some only of the members or all the members constitute themselves into a firm and continue the business.

INCOME TAX LEGISLATION.

Income Tax Amendment Act.

An important amendment to the Indian Income-tax Act has been passed by the Assembly with meteoric rapidity. The object of the amendment is to put an end to the avoidance of taxation by means of nominal partnerships between husband and wife or a minor child or by an association consisting of husband and wife, when there is no substantial separation of interests of the assessee and the wife or the child. It appears that the recent Income-tax Enquiry Committee have singled out this particular matter for immediate treatment because the Committee believe that avoidance of taxation under cover of law is widespread. The Government expect to gain an increase of at least Rs. 20,00,000 per year by way of income-tax by the introduction of this amendment. We also find that an amendment to the proposed Bill to the effect that in computing the total income of any individual for the purpose of assessment there shall be included so much of the income of the wife or the minor child of such individual as arises directly or indirectly from membership of a firm or partnership has also been carried and passed. We hope to publish the Amendment Act in its final form in the next issue for the information of our readers.

Report of the Income Tax Enquiry Committee.

The report of the Income-tax Enquiry Committee has been published by the Government. The first part of the Report deals with those provisions of the Income-tax Act which relate to the scope of the Act and the quantification of liability and in the second part the statutory provisions of assessment and the procedure and the administration of the Act are considered. The report will be reviewed by us in the next issue.

Income Tax Reports.

VOL. V, PART III.

THE INCOME-TAX ENQUIRY COMMITTEE REPORT.

The report submitted to the Government of India by the Income Tax Enquiry Committe has been published. Though we thought at first that several criticisms may have to be made, a careful study of the report has only evoked sincere admiration for the very careful, precise, practical and impartial recommendations made by the Committee. The public of India must ever be grateful to the learned members of the Committee for the services rendered by them.

The omission of the Government of India to include in the personal of the Committee lawyers having experience in income tax law and acquainted with the intricacies of the land tenures of India has however marred the value of the report in some places.

The law of income tax is, as several Lord Chancellors of England have repeatedly observed, a very difficult branch of the law; the line which divides income from capital is very narrow and we hope the Government will take the advice of some experienced lawyers before accepting all the recommendations of the committee.

In particular we think the chapter on 'Legal Avoidance requires careful scrutiny, for some of the suggestions clearly amount to taxation of capital and involve an unjustifiable alteration, for purposes of income tax, of the true legal relationship of parties. We would invite the immediate and careful attention of the public to this chapter. The subject of undivided Hindu families also requires deeper consideration. We would also impress upon the Government the following words which appear in the introduction to the Report:

"*It cannot be too strongly emphasised that many of these recommendations are inter-related and should be read together, rejection or modification of the one necessitating rejection or modification of others.*"

The procedure which is now being followed by the Government of introducing some of the provisions alone is contrary to these emphatic words of the Committee and may do incalculable harm, especially if they are enacted before the safeguards, such as the separation of the appellate and administrative functions of Assistant Commissioners, are introduced.

We are giving below a summary of the recommendations of the Committee with brief comments wherever necessary. The Sections of the United Kingdom Finance Act 1936, on which some of the recommendations of the Committee are based, will be printed in the next issue.

Summary of the Recommendations of the Income Tax Enquiry Committee

1. **Foreign Income of Residents in British India.**—(i) Foreign income of a resident in British India is at present assessable only to the extent to which it has been received in or brought into British India. The committee recommend that foreign income of residents in British India should be dealt with on the basis of the whole income arising in British India. Incidentally, this would provide for the allowance of foreign business losses. The only modification of this general rule that is recommended is that salaries earned abroad should only be chargeable where the recipient is absent from British India for the purpose of his employment for a period not exceeding 6 months.

(ii) Remittances received by a wife out of such part of her husband's income as is not liable to assessment in his hands should be deemed to be income arising to her and assessable in her hands.

(iii) A company should be treated as resident in British India if it is controlled in British India at any time during the year in which the profits sought to be assessed arise.

2. **Non-Residents' Income Arising in British India.**—(i) The non-resident on whose behalf goods are *regularly* sold in British India should be made assessable in respect of the profits arising therefrom, whatever may be the type of representative employed. The Committee considers that it would be undesirable to attempt to tax the profits arising where an agent only receives casual consignments and does not *regularly* act for the consignor.

(ii) Statutory power must be given to an agent acting regularly for a non-resident principal, to retain a sum equal to the estimated tax liability, and in a case where there is disagreement between the principal and the agent upon the question of the reasonableness of the amount retained, the certificate of the Income tax Officer as to a reasonable amount should be sufficient authority for retention of such an amount pending final ascertainment of the liability.

(ii) Persons liable to assessment under this provision should be required by the Act to make returns whether or not individual notices have been served upon them and the time limit for additional assessment should be extended to six years, except in the case of the income of a non-resident assessable in the name of a resident agent.

(iii) when profits arising from goods sold is attributable in part only to the operations of sale, only the proportion of profits attributable to the operations carried out in British India should be assessable. Thus in the case of sale of goods imported into British India by a non-resident, his liability should correspond to the profits that would normally be made by a resident if he imported such goods and dealt with them in a similar manner. Similar considerations apply to the case of the non-resident purchasing goods in British India for resale abroad.

(iv) For the words "shall be chargeable to income-tax in the name of the agent" in Section 42 (1), the words "shall be chargeable to income-tax either in the name of the non-resident or in the name of the agent" should be substituted in order to leave no doubt that such income is also directly assessable and there should be a right of appeal from orders under Section 43.

(v) All income payable to non-residents arising in a primary sense from British Indian sources, eg., pensions originating in British India and interest payable on securities and other payments such as interest (other than interest on securities), patent royalties and rents should be made liable to Indian income tax.

3. Religious and Charitable Exemptions.—Private religious trusts which do not enure to the benefit of the public should not be exempt, and business carried on by the trustees of a religious or charitable trust should be exempt only when the business activities are in themselves the primary purpose of the charity, or when the work in connection with the business is mainly carried on by the beneficiaries.

Agricultural Income—(i) Income from agriculture should be taken into account for the purpose of determining the rate at which tax on the other income should be assessed.

(ii) As income arising wholly from agriculture in an Indian State is exempt in British India, the agricultural proportion of the profits should be exempt where crops are raised in a State and sold in British India.

[NOTE. The definition of agricultural income in Sec. 2 (1) and the insertion of the last proviso to Sec. 4 (2) have created an anomaly, as shown in the case of *Mohanpura Tea Company Ltd.*, 1937 I.T.R. 118 and this recommendation will remove the anomaly.]

(iii) There is, however, no justification for the existing exemption of agricultural income from land in a State for which any annual payment is made to the State, and the committee recommend its withdrawal.

[NOTE: We think this recommendation is not sound, especially in view of the coming federation of India. Indian States should be treated as far as possible like sister provinces].

(iv) In the case of usufructuary mortgages whether the loan is made in the course of a money-lending business *or otherwise*, the income therefrom should be assessable to tax.

[NOTE: We entirely disagree. Under the system of land tenures in India, especially South India, land is held under various kinds of usufructuary mortgages, like *kanam*, *panayam*, *otti*, in which only a nominal amount is paid to the landlord and the tenant makes very valuable improvements and the income is mostly from tenant's improvements. The law as laid down by the Privy Council in *Maharaja of Dharbanga's case*, 1935 I.T.R. 305 must be followed.]

5. **Local Authorities**—Since such bodies may be enaged in trading activities, the extent of their trading must be investigated with a view to reconsider the existing exemption.

6. **Exemptions under Section 66 (1) (ii)**—(i) As regards Government pensions not covered by Sec. 272 of the Government of India Act and pensions paid by commercial concerns, etc., there is no statutory bar against making them liable to tax and the major consideration that pensions earned in British India should pay British Indian tax should prevail. If this be accepted, liability should not depend upon the accident of the place at which the pension may be made payable, but should extend to all pensions earned in British India.

(ii) As regards leave allowance or salary paid outside British India exemption is now allowed in respect of—

(*i*) the allowance or salary paid in the United Kingdom to officers of Government on leave or duty in that country whether such allowance or salary is paid in sterling in the United Kingdom or by means of negotiable rupee drafts on a bank in India; (*ii*) the leave allowance or salary drawn from any Colonial Treasury by officers of Government on leave or duty in the Colony and (*iii*) leave salaries or leave allowances paid in the United Kingdom or in a Colony to officers of local authorities, or to the employees of companies or of private employers, on leave in the United Kingdom or in such Colony.

Whatever justification there may have been originally for this exemption, there is no justification for it now and it should be revoked.

7. Interest on securities payable abroad charged on Indian Revenues or on Indian Income—(i) If it is desired to bring sterling securities within the scope of British India Income Tax, this could only be done by amendment of the Government of India Act by the United Kingdom Legislature. In such an event, special machinery for the deduction of tax would need to be provided.

(ii) A definite distinction can be drawn between the case of a security issued by a commercial concern and one that is issued by the taxing authority itself and in the case of interest on securities payable without British India by an assessee in British India, provision should be made for the taxation of such interest by an amendment of Section 8 of the Act, deeming such interest to arise or accrue in British India.

8. Casual and Non-recurring receipts—Transactions of purchase and resale should be liable to taxation only if these are sufficiently numerous or so organised as to constitute the carrying on of a trade. An explanation should be added to Section 4 (3) (vii) to the effect that the word "casual" in relation to transactions of purchase and resale covers all such transactions as do not, by reason of their number or organisation, amount to the carrying on of a business.

9. Basis of charge of income tax—The Committee strongly recommend the adoption of a suitable "slab" system instead of the scale system now adopted by the Government, and give in Appendix 2 a specimen scale.

10. **Life assurance premiums**—(i) As regards policies effected outside British India there seems to be sufficient reason for their exclusion from relief in the fact that the interest and profits accruing to the Assurance Company are not subject to British India Income tax. (ii) This allowance should be given as a deduction; maximum allowable may be fixed at Rs. 6,000; and one half of the allowable premium may be deducted from the total income to arrive at the income assessable.

11. **Provident fund contributions**—(i) Whether or not the "slab" system be adopted, interest credited so far as it does not exceed 6 per cent, on the accumulated balance in the provident funds and does not exceed one third of the salary for the same year, should be deducted from the employee's total income, inclusive as at present of employee's contributions and added interest, in computing the income to be taxed, and disallowed sums should no longer be segregated in order to compute for further disallowance the interest thereon. This will simplify the present method.

(ii) To cover cases where an employee ceases to be a member within five years, the provisions of Section 58-G, sub-section (3), should be amended to provide that a calculation of tax payable on the total income of all the years concerned shall be made as if, in his case, the fund had not been recognised, and from the total amount of tax so computed, there shall be deducted the total amount of tax already collected for those years, the balance, if any, being payable by the employee.

(iii) Official funds (*i.e.*, those to which the Provident Funds Act, 1925, applies) should be required to fulfil the same conditions as any others in order to obtain Income Tax exemptions. Chapter IX-A of the Income Tax Act, with the Indian Income Tax (Provident Funds Relief) Rules, should be made applicable to all Provident Funds in respect of which income tax relief is granted.

(vi) Superannuation Fund Contributions should receive similar treatment to that accorded to Provident Funds. The contributions by an employer to a properly constituted trust for the provision of employee's pensions are already allowed to him as an item of expense; similarly the contributions of employees and the interest earned by the fund should also be exempted. Equity and logic alike support this claim and its adoption is recommended.

12. **Company Super-Tax.**—The Exemption limit of Rs. 50,000 is clearly illogical. Small companies derive relatively as much advantage as large ones from the privilege of incorporation and the amount of profit made by a company bears no necessary relation

to the wealth or poverty of its shareholders. It is recommended therefore that the present exemption limit, which seems to have been based on a false analogy should be abolished.

13. **Wife's Income**—The income of a wife should be deemed to be, for income tax purposes, the income of her husband, but where the income of the wife is derived from her personal exertions and is unconnected with any business of her husband, her income from her personal exertions up to a certain limit, say Rs. 500, should not be so included. To avoid an undue proportion of tax falling upon the wife or the husband, on application by either husband or wife, within a period to be specified, the husband and wife should be separately assessed in respect of his or her income, and the tax chargeable on each shall be that proportion of the tax assessable on the joint income that the income of the spouse bears to the aggregate of the two incomes.

14. **Income of Minor Children**—Income of a minor should be deemed to be the income of the father (i) if it arises from the benefits of partnership in a business in which the father is a partner or (ii) if, being the income of a minor other than a married daughter, it is derived from assets transferred directly or indirectly to the minor by his or her father or mother, (iii) if it is derived from assets apportioned to him in the partition of a Hindu Family.

15. **Partnership**—In relation to partnerships the Committee recommend, after considering the various difficulties that exist at present :—(i) That in general the Assistant Commissioners should make more use of their powers under Rule 2 (c) to permit registration at any time up to the determination of any appeal. The abuses in cases to which Section 26 of the Act applies owing to the production of new partnership deeds specially drawn up to affect the apportionment of the profits assessed should disappear if the recommendation of the Committee relating to *Succession* is accepted.

(ii) That the form of return for a partnership should provide for declaration of the constitution of the partnership and of the basis on which profits of the "previous year" have been divided, and that such declaration, if supported by proper accounts, should normally suffice for automatic re-registration as long as there is no change from the particulars recorded at the date of the last registration.

(iii) That when the Income Tax Officer is satisfied that non-registration involves less tax being paid than would be paid otherwise, he should be empowered to deal with a firm not claiming registration in the same manner as if it were registered. This is

intended to meet the type of cases in which non-registration is used to reduce the tax payable.

(iv) The position regarding registration of a firm following the execution of a partnership deed should be made clear to the public. A suggested method is the enclosure, with the return form issued to each firm, of a short memorandum on the subject.

(v) The actual basis of division obtaining in the previous year should govern the division of the assessable profits of that year between the partners and not the basis at the time of making the assessment as provided in Section 14 (2) (b).

(vi) A uniform method of computing the individual partner's shares of a firm's profit or loss is recommended.

(vii) In the computation of the profits of a firm whether registered or not, no deduction should be made in respect of any sum, whether described as salary, interest, commission or otherwise, which is payable to a partner, and any partner's assessable income from partnership business should be his actual share of the profit or loss of the previous year calculated on the lines indicated above.

(viii) The profits of each partner in a registered firm should be assessed upon him personally but in the name of the firm in the case of a non-resident partner, Section 44 of the Act being expanded to provide for the recovery of tax in such cases.

16. Hindu Undivided Families—Though the Committee recognize that there is some case for the recognition of the special position Hindu undivided families, since, however, the effect on the Revenue of any concession would be very considerable, they had to take into account the practicability of the various suggestions made. If the Government is prepared to accept the reduction in the yield of tax involved, a practicable concession, (which the Committee consider should not be exceeded in view of what is said above), would be to ascertain the rate of tax applicable, in cases where there are more than one adult married male member, by dividing the family's income by two, but to include in the income of the Joint Hindu Family the individual income of all members (including wives and minor children) from whatever source derived whether covered by the Hindu Gains of Learning Act or not, and to abolish the special scale of super-tax rates for Undivided Families.

(To be continued).

Income Tax Reports.

VOL. V, PART IV.

THE NEW YEAR'S BUDGET AND INCOME TAX

Deterioration of Income Tax Revenue.

The Revised Budget for the year 1936-37 shows, instead of the anticipated surplus of Rs. 6 lakhs, a deficit of Rs. 197 lakhs. There is an excess of Rs. 25 lakhs in expenditure and a deterioration of Rs. 178 lakhs in revenue. The main elements in the total deterioration of Rs. 178 lakhs are Rs. 216 lakhs under Customs, Rs. 37 lakhs under Income-tax and 28 lakhs under Currency. There was an increase of 41 lakhs, 37 lakhs and 10 lakhs respectively under the headings Central Excise, Miscellaneous and Salt.

Causes of Deterioration.

With regard to this decrease in income-tax revenue the Hon'ble Finance Member says:

" The deterioration of Rs. 37 lakhs under this head is due in the main to two causes The first is a decline in income tax receipts from sugar manufacturing companies. The establishment of an unnecessarily large number of sugar factories in certain areas has inevitably led to price-cutting, started primarily by companies which, owing to financial or climatic reasons were unable to hold stocks. This has entailed a considerable reduction in the profits of the industry as a whole. The other cause is the fall in the profits of money-lenders. Provincial Rural Indebtedness Acts while improving the position of the debtor have reduced recoveries and made the lender less willing to make further advances so that there has been a falling off both as regards his rate of profit and as regards his volume of business."

Proposals for 1937-38.

The Government propose to make up the deficit for the year 1937-38 (1½ crores) by improving and tightening up the administration of existing taxes', including income tax. The first measure adopted by the Government is the enactment of the Income Tax (Amendment) Act (IV of 1937) which proposes to consolidate the income of the husband and wife and of father and minor chidren. The Government expect Rs. 20 lakhs next year

from this Amendment alone." The Budget for 1938-39 may tell us whether the hopes of the Government are based on reliable data or mere imagination.

The Second step proposed to be adopted is the 'tightening up of the machine' of the administration of Income tax. The Finance Member observes:

"Personally I believe that, given time, we could find it (the deficit of 1½ crores) by improving and tightening up the administration of existing taxes. The Amendment in the Income Tax Act brought forward in the current session is expected, besides arresting the further deterioration which would have attended the continuance of the practice with which it dealt, to yield an immediate improvement of Rs. 20 lakhs in the coming year and credit for this amount has been taken in the estimates I have placed before the House."

INTRODUCTION OF NEW MEASURES.

Referring to the Report of the Income-tax Enquiry Committee, the Finance Member states:—The other recommendations contained in the Income Tax Enquiry Report are broadly speaking of two kinds. Some are concerned with changes in the Indian Income tax system, and involve questions of principle on which it is desirable that public opinion should be elicited before it is decided to put forward legislation to carry them into effect. I have already taken steps to consult representative bodies and interests on these suggestions. The remaining recommendations of the Report are concerned with the administration of the department, and consist of proposals tightening up the machine so as to secure the most efficient assessment and collection of the tax, accompanied by suggestions for alleviation of certain hardships which are regarded as affording ground for legitimate complaint by the taxpayer. I propose to take up without delay the consideration of the possible improvements in administration with a view to the early introduction of reforms which are agreed to be necessary."

BUDGET ESTIMATE FOR 1937 38.

The Budget estimate of income tax revenue for 1937-38 is Rs. 14,30 lakhs as against the revised estimate of Rs. 15,30 lakhs for 1936-37. After allowing for a loss of Rs. 1,40 lakhs owing to the separation of Burma, the estimate for 1937-38 anticipates an improvement of 40 lakhs of which Rs. 20 lakhs is due to the measures to be taken under the Income tax (Amendment) Act IV of 1937.

THE INCOME TAX (AMENDMENT) ACT, IV OF 1937.

The Income Tax Amendment Act (IV of 1937) received the assent of the Governor-General on the 4th March, 1937. The objects of the amendment are stated in the following 'statement of objects and reasons':—

"Reference in Secs. 1 and 4 of Chapter III of the Income Tax Enquiry Report, 1936, to the practices of avoiding taxation by means of nominal partnerships between husband and wife or parent and minor child or by the nominal transfer of assets to a wife or minor child (or to an "association" consisting of husband and wife) when there is no substantial separation of the interests of the assessee and the wife or child. These practices are reported to have become very widespread already, with considerable detriment to the revenue, and there is little doubt that if they are not checked there will be progressive deterioration. The proposals in the Report regarding the aggregation of the income of husband and wife go beyond the immediate necessities of the case and to that extent their adoption would involve the admission of a new principle which the Government of India do not desire to establish in advance of the general public discussion of the Report which has been arranged; and the present Bill has been so drafted as to deal only with the abuses to which I have referred."

The text of the Act is printed below:

THE INDIAN INCOME TAX (AMENDMENT) ACT, 1937.

ACT No. IV OF 1937.

[Received the Governor-General's assent on 4th March 1937.]

An Act further to amend the Indian Income-tax Act, 1922, for certain purposes.

WHEREAS it is expedient further to amend the Indian Income-tax Act, 1922 (XI of 1922) for the purposes hereinafter appearing; It is hereby enacted as follows:—

Short title.

1. This Act may be called the Indian Income tax (Amendment) Act, 1937.

Amendment of S. 16 Act XI of 1922.

2. To Section 16 of the Indian Income-tax Act, (hereinafter referred to as the said Act), the following sub-section shall be added, namely:—

"(3) In computing the total income of any individual for the purpose of assessment, there shall be included—

(*a*) so much of the income of a wife or minor child of such individual as arises directly or indirectly—

(*i*) from the membership of the wife in a firm of which her husband is a partner;

(*ii*) from the admission of the minor to the benefits of partnership in a firm of which such individual is a partner;

(*iii*) from assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration or in connexion with an agreement to live apart; or

(*iv*) from assets transferred directly or indirectly to the minor child, not being a married daughter, by such individual; and

(*b*) so much of the income of any association of individuals consisting of such individual and his wife as arises from assets transferred to the association by such individual."

3. To sub-s. (5) of Section 18 of the said Act the following proviso shall be added, namely :—

Amendment of S. 18, Act XI of 1922. "Provided further that where such person or owner is a person whose income is included under the provisions of sub-s. (3) of Section 16 in the total income of another person, that person shall be deemed to be the person or owner on whose behalf payment has been made and to whom credit shall be given in the assessment for the following year."

4. After sub-s. (3) of Section 48 of the said Act the following sub-section shall be inserted, namely :—

Amendment of S. 48, Act XI of 1922. "(3-A) Where the shareholder referred to in sub-sec. (1) or the member of a registered firm or the minor admitted to the benefits of partnership referred to in sub-sec. (2), or the owner of a security referred to in sub-s. (3) is a person whose income is included under the provisions of sub-sec. (3) of Section 16 in the total income of another person, the provisions of sub-secs. (1), (2) and (3) shall apply as if that person were himself the person entitled to a refund under those sub-sections."

5. The amendment made in the said Act by Section 2 shall not have effect in respect of any income chargeable to income-tax for any year ending before the 1st day of April 1937.

Operation of S. 2.

The Indian Finance Act, 1937.

[Received the assent of the Governor-General on the 31st March, 1937]

The following Act, which has been assented to by the Governor General under the provisions of clause (b) of sub-section (1) of section 67 B of the Government of India Act, and has been expressed to be made by the Governor-General under the provisons of sub-section (2) of the same section, is published for general information in the Gazette of India dated April 3, 1937:—

An Act to fix the duty on salt manufactured in, or imported by land into, certain parts of British India, to vary the excise duty on sugar leviable under the Sugar (Excise Duty) Act, 1934, to vary certain duties leviable under the Indian Tariff Act, 1934, to vary the excise duty on silver leviable under the silver (Excise Duty) Act, 1930, to fix maximum rates of postage under the Indian Post Office Act, 1898, and to fix rates of income-tax and super-tax.

WHEREAS it is expedient to fix the duty on salt manufactured in, or imported by land into, certain parts of British India, to vary the excise duty on sugar leviable under the Sugar (Excise Duty) Act, 1934, to vary certain duties leviable under the Indian Tariff Act, 1934, to vary the excise duty on silver leviable under the Silver (Excise Duty) Act, 1930, to fix maximum rates of postage under the Indian Post Office Act, 1898, and to fix rates of income-tax and super-tax; It is hereby enacted as follows:—

Short title and extent. 1. (1) This Act may be called the Indian Finance Act, 1937.

(2) It extends to the whole of British India, including British Baluchistan and the Sonthal Parganas.

Fixation of salt duty. 2. The provisions of section 7 of the Indian Salt Act, 1882, shall, in so far as they enable the Governor-General in Council to impose by rule made under that section a duty on salt manufactured in, or imported into, any part of British India other than Burma or Aden, be construed as if, for the year beginning on the 1st day of April, 1937, they imposed such duty at the rate of one rupee and four annas per maund of eighty-two and two-sevenths pounds avoirdupois of salt manufactured in, or imported by land into, any such part, and such duty shall, for all the purposes of the said Act, be deemed to have been imposed by rule made under that section.

Amendment of section 3, Act XIV of 1934. 3. In sub-section (2) of section 3 of the Sugar (Excise Duty) Act, 1934,—

(*a*) in clause (*i*), for the words "ten annas" the word "one rupee and five annas" shall be substituted.

(*b*) in clause (*ii*), for the words "one rupee and five annas" the words "two rupees" shall be substituted.

Amendment of the first Schedule to Act XXXII of 1934. 4. In the first Schedule to the Indian Tariff Act, 1934:—

(*a*) in Item No. 17, for the words and figures "Rs. 9-1 per cwt." in the fourth column the following words and figures shall be substituted, namely:—

"the rate at which excise duty is for the time being leviable on sugar, other than *khandsari* or palmyra sugar, produced in British India *plus* Rs. 7-4 per cwt.";

(*b*) in Items Nos. 61 (2) and 62 (1), for the words "two annas per ounce" in the fourth column the words "three annas per ounce" shall be substituted.

Amendment of section 3, Act XVIII of 1930. 5. In sub-section (1) of section 3 of the Silver (Excise Duty) Act, 1930, for the words "two annas" the words "three annas" shall be substituted.

Inland Postage rates. 6. For the year beginning on the 1st day of April, 1937, the Schedule contained in the Schedule to this Act shall be inserted in the Indian Post Office Act, 1898, as the First Schedule to that Act.

Income-tax and super-tax. 7. (1) Income-tax for the year beginning on the 1st day of April, 1937, shall be charged at rates applicable to the total income of each assessee the same, and increased in each case by the same fraction of the amount of the rate, as for the year beginning on the 1st day of April, 1936.

(2) The rates of super-tax for the year beginning on the 1st day of April, 1937, shall, for the purposes of section 55 of the Indian Income-tax Act, 1922, be the same rates, increased in each case by the same fraction of the amount of the rate, as for the year beginning on the 1st day of April, 1936.

(3) For the purposes of sub-section (1) "total income" means total income as determined in accordance with the provisions of the Indian Income-tax Act, 1922.

[Schedule relates to Postage rates and is not printed here].

Income Tax Reports.

VOL. V, PART V.

THE JUDICIAL COMMITTEE ON BEST JUDGMENT ASSESSMENT.

LAXMINARAIN BADRIDAS'S CASE [1937 I.T.R. 170].

Under Section 23 (4) of the Indian Income Tax Act if a person fails to make a return under Section 22 (1) or Section 22 (2) or fails to comply with all the terms of a notice under Section 22 (4) to produce accounts or with the terms of a notice under Section 23 (2) to produce evidence, the Officer shall make an assessment 'to the best of his judgment'. The Act does not give any indication as to what constitutes an assessment to the best of the judgment or how or on what materials an assessment to the best of the judgment is to be made. The decisions on the subject are also not very clear. Cases in which Section 23 (4) has to be invoked and an assessment made to the best judgment are, however, of very common occurrence in practice. The recent decision of the Judicial Committee in *Laxminarain Badridas's Case* reported below at page 170, in which their Lordships of the Privy Council have laid down in clear terms what constitutes a best judgment assessment will therefore be read with great interest by income tax authorities and assessees. The duties of an Income Tax Officer in making a best judgment assessment are laid down in the judgment in these words:—

"He must not act dishonestly or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances and his own knowledge of previous returns by, and assessment of, the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the matter, it must be honest guess-work. In that sense, too, the assessment must be to some extent arbitrary. Their Lordships think that the section places the officer in the position

of a person whose decision as to amount is final and subject to no appeal, but whose decision if it can be shown to have been arrived at without an honest exercise of judgment may be revised or reviewed by the Commissioner under the powers conferred upon that official by Section 33".

Theory of 'Local Enquiry'.

Referring to the theory laid down by the Nagpur Judicial Commissioner's Court that an assessment cannot be an assessment to the best of the officer's judgment unless the officer (i) conducts the local enquiry before making the assessment and (ii) records a note of the details of the results of such enquiry, their Lordships say that they find it impossible to extract these requirements from the language of the Act. Nor can they find any such justification in the authorities upon which the Judicial Commissioners appear to have relied. The authorities, in their Lordships' opinion, do no more than affirm that the officer must exercise judgment and must not act on mere caprices or in any other way inconsistent with the exercise of judgment. Their Lordships agree with the views expressed by the Rangoon High Court in *Abdul Bari Chowdhury's Case* (I.L.R. 9 Rang. 281).

We are glad to find that the judgment of the Privy Council tallies exactly with the opinion which we had expressed in our comments on the judgment of the Judicial Commissioner's Court in *Laxminarain's Case.* At p. 37 of Vol. II in our *Notes and Comments*, we said:

"With all respect to the learned Judicial Commissioners we think they have gone too far. We do not think there is any justification whether in the Act itself, or the several cases which have been referred to by the learned Judges in their judgment for laying down any such broad propositions. The Legislature has wisely left the matter with saying that the Income Tax Officer should make an assessment "to the best of his judgment" in such cases, and we do not think that we are justified in imposing any obligation upon the Income Tax Officers as a matter of law either to make any local enquiry or to record the results of such enquiry. Nor are we aware of any decided case from which such rules may be deduced though, of course, the decisions have laid down—and laid down rightly—that an assessment under Section 23 (4) should be made 'according to the rules of reason and justice, not according to private opinion: according to law, not according to humour' and that such an assessment must not be arbitrary, vague and fanciful, but legal and regular.'

Best Judgment assessment Not a Matter of Discretion.

Their Lordships' judgment also establishes that an assessment under Section 25 (4) is not discretionary. They say "under Section 23 (4), the fact of failure to comply with a notice under Section 22 (4) makes it compulsory on the officer to make an assessment under Section 23 (4) and under Section 27 unless the officer is satisfied that the assessee had not a reasonable opportunity to comply, or was prevented by sufficient cause from complying, with that notice the assessment must stand."

Reference in Best Judgment Assessment Cases.

Adverting to references from best judgment assessment cases their Lordships have thrown out the caution that it is not possible to turn a mere question of fact into a question of law by asking whether as a matter of law the officer came to a correct conclusion upon a matter of fact. If an assessment has been made to the best of the officer's judgment it must stand unless the assessee succeeds in satisfying the officer that he had not a reasonable opportunity to comply, or was prevented by sufficient cause from complying, with the terms of the notice under section 22 (4) and if he fails to do so upon the undisputed or proved facts of the case the matter should end there unless the Commissioner chooses to proceed under section 33. Where the questions involved in such cases are purely questions of fact, no reference should be made under section 66 (2).

ADJOURNMENT OF INCOME TAX INQUIRIES.

The Judicial Committee have also made some important observations in the above mentioned case on the respective duties of Income Tax Officers and assessees in the matter of adjournment of Income tax inquiries. Their Lordships say that they are unaware of any rule by which an Income Tax Officer is bound or ought to announce beforehand how he proposes to deal with an application for adjournment. Where an assessee has already obtained an adjournment it is his duty if he desires a further adjournment to apply at a date sufficiently early to enable him in the case of a refusal to be prepared to proceed on the appointed day. If he does not do so and an application is made on the very day appointed for compliance with the order, and the Income Tax Officer does not find any ground for granting further adjournment he will be justified in making an assessment to the best of his judgment.

ASSISTANT COMMISSIONER'S POWER TO ADMIT ADDITIONAL GROUNDS OF APPEAL

LAHORE HIGH COURT'S VIEW.

In the case of *Ram Rakha Mal and Sons* (1937 I.T.R. 137) the learned Judges of the Lahore High Court have laid down that 'an Assistant Commissioner has no authority to admit a new matter raised in the form of an additional ground of appeal after an appeal has once been admitted, whether within the period prescribed therefor or after its expiry. All that he can do under this enabling provision is to admit an appeal for the first time even if it is presented after the period prescribed therefor.' Their Lordships concede that at first sight this proposition may look startling but state that a reference to the provisions relating to appeals under the Code of Civil Procedure will make their meaning clear. Their Lordships' reasoning is this: the Indian Limitation Act prescribes the period of limitation for appeals; Section 5 of that Act confers authority upon appellate Courts to admit appeals even after the expiry of the period of limitation prescribed therefor; and in spite of the power so vested, the legislature has specifically provided in Order 41, Rule 2, of the Civil Procedure Code for the admission of additional grounds of appeal, by leave of the Court. No such provisions is contained in the Income Tax Act which, relating to matters expressly dealt with therein, is self-contained. It is clear therefore, in their Lordships' view that when once a memorandum of appeal is put in under Section 30 no new matter can be raised afterwards.

IS THIS VIEW CORRECT?

With all respect, we find it difficult to appreciate the force of this argument. The fact that there is a special provision in Order 41, Rule 2, Civil Procedure Code, and there is no such provision in the Income Tax Act does not necessarily lead us to the conclusion that the Assistant Commissioner of Income Tax has no power to admit an additional ground of appeal. It is obvious that the Income Tax Act does not purport to deal with matters of procedure in detail like the Civil Procedure Code. The power to admit an appeal after time, we think, includes the power to admit an additional ground of appeal and we are of the opinion that under Section 30 (2) Assistant Commissioners must be held to have such power so long as the Legislature

has not expressly taken it away. The fact that there is a special provision in the Civil Procedure Code for permitting additional grounds of appeal does not imply that such power is not included in the power to admit an appeal out of time. Apart from this, we are of opinion that once an appeal has been preferred the Assistant Commissioner has ample power to consider all the points that arise in the case whether raised in the grounds of appeal or not. The technical rules as to pleadings are not applicable to income tax inquiries and even in Courts of Law the old procedure of strictly confining a litigant to his pleadings is not favoured much nowadays.

This, of course, does not mean that the Assistant Commissioner is bound to admit any and every ground of appeal which the assessee may think fit to raise after filing the appeal, but we only mean that *he has power* to allow an additional ground to be raised, in his discretion, if he thinks justice requires it. The broad proposition laid down by their Lordships that 'he has no authority under that sub-section [Section 30 (2)] to admit a new matter raised in the form of an additional ground of appeal whether within the period prescribed therefor or after its expiry should, we think, be reconsidered.

Desirability of Amending Section 30 (2)

If, as their Lordships hold, Section 30 (2) is capable only of the construction put by their Lordships on it, there is a clear case for amending the section by adding a provision similar to Order 41, rule 2, Civil Procedure Code, and we would invite the attention of the Central Board of Revenue to this matter.

CONVERSION OF HINDU UNDIVIDED FAMILIES INTO FIRMS OR COMPANIES.

Mittarchand Lakhmidas's Case.

In *Mittarchand Lakhmidas* v. *Commissioner of Income Tax, Punjab* (1937 I.T.R. 127), to which we had referred in our March issue it was held by the Lahore High Court that Section 25-A of the Indian Income Tax Act applies only to those cases where the question involved is one of pure and simple disruption of a Hindu Undivided Family unattended by conversion or transformation into a new entity and that Section 26 is intended to cover all cases which are specified in clauses 1 and 2 thereof in whatever way the situation envisaged there may arise. Accordingly it was held in that case that if in the place of a Hindu Undivided Family a new firm

is constituted or a new company brought into existence assessment should be made in accordance with Section 26 and not under Section 25-A.

RAM RAKHA MAL'S CASE.

In a still later case *Ram Rakha Mal & Sons* v. *Commissioner of Income tax, Punjab* (1937 I.T.R. 137), the Lahore High Court has reiterated this principle and further considered another aspect of this question which is of greater importance to assessees. Where the members of a Hindu Undivided Family form themselves into a limited company to carry on a business or some of the businesses of the family *without effecting a complete partition between themselves* how is the assessment to be made? Can an assessment be made upon the company to the extent to which it is found to have actually succeeded to those businesses which are separable from the rest, and can the Hindu Family be assessed at the same time as a family under Section 25-A in respect of the income from the other business or sources? Their Lordships have answered this question in the affirmative. No doubt a Hindu Undivided Family and a firm or a limited company are mutually exclusive and cannot co-exist and accordingly without complete disruption the conversion of a Hindu Undivided family into a firm or company in its entirety is inconceivable, and so long as it remains undivided the question of succession to it *as a whole* by another entity does not arise: but, as it is possible under the income tax law that a person conducting several businesses may be succeeded in a particular business which is divisible from the other businesses of his, a Hindu Undivided Family as a person can in the matter of such business be succeeded by a company to that extent. It is therefore open to the members of a Hindu Undivided family to form themselves into a limited company to carry on the business or one of the businesses of the family without effecting a complete partition and in such a case there is nothing illegal in assessing the company as a successor in respect of the income of the business and continuing to assess the undivided family as such in respect of its other income.

The question as to the rate at which income tax is to be levied on a company which is assessed under Section 26 (2) as successor of a Hindu Undivided Family is also considered in this case. Their Lordships have held, following the decision of the Privy Council in the *Western India Turf Club's Case* (I.L.R. 52 Bom. 123) that

the assessment on the successor is to be made as if he had been carrying on the business throughout the previous year. It has been further pointed out that in case of succession under Section 26 (2) income is to be computed with reference to the position at the time it was earned although the charge of tax computed on that basis is laid upon the successor.

THE MADRAS VIEW.

This view conflicts with the opinion of the Madras High Court expressed in *Thontepu Chinna Pullayya* v. *Commissioner of Income Tax, Madras* (1937 I.T.R. 132), in which it was held that when all the members of a Hindu undivided family after separation and partition constitute themselves into a firm in order to continue the business carried on by the undivided family the assessment of the total income of the undivided family up to the date of separation and partition should be made in accordance with Section 25-A (2) of the Income Tax Act on the members as if no separation or partition had taken place. The Judges of the Madras High Court are of opinion that Section 26 (2) is not applicable to such a case as there is no change of ownership and the assessment cannot be made on the firm carrying on the business as successors of the family within the meaning of Section 26 (2). The decision has been expressly dissented from by the Lahore High Court in *Ram Rakha Mal's Case* but there is this difference to be noted between the two cases, namely, that in the Lahore Case the members had formed themselves into a limited company which is a distinct legal entity. In the case of a company there is clearly a transfer of ownership from the members to the company. Where they form themselves only into a firm the question whether there can be said to be a transfer of ownership is not so clear. But the decision of the Lahore High Court in *Mittarchand Lakhmi Das's Case* lays down that even in cases where the members form themselves into a firm, assessment is to be made under Section 26 and not under Section 25-A (2). None of these decisions applies directly to a case where, without complete separation the members form themselves into a *firm* to carry on one of the businesses of the family but the decision in *Ram Rakha Mal's Case* is not on the face of it confined to limited companies. Their Lordships appear to be of the view that the principle would apply also to cases where the members form themselves into a firm without effecting a complete partition.

EXEMPTION OF INCOME FROM COFFEE GROWN IN NATIVE STATE BUT CURED AND SOLD IN BRITISH INDIA.

Judgment was pronounced by the Madras High Court on the 29th of April in the case of *Dewan Bahadur S. L. Mathias* [O.P. No. 181 of 1936] in which a question of great importance to persons owning agricultural lands in Native States and to planters owning coffee estates in particular arose for decision. The assessee who resided in British India owned some coffee estates in the Mysore State. Coffee grown in those estates was transported to British India and handed over to a company at Mangalore to be cured and sold, and the company paid to the assessee the sale proceeds less the curing charges and commission on the sales. The Commissioner was of opinion that the income was not agricultural income but income from business, that the income accrued entirely at Mangalore in British India and it was not therefore exempt from taxation. The question "whether any part of the income derived by the petitioner from the produce of his coffee estates in Mysore was exempt from taxation under the second proviso to Sec. 4 (2) of the Indian Income Tax Act as being income that has accrued or arisen outside British India" was referred to the High Court.

After hearing elaborate arguments on both sides the High Court held that the whole of the income received by the assessee by the sale in Mangalore of the produce of his coffee estates in Mysore was exempt from taxation. Their Lordships refused to follow the decision of the Calcutta High Court in the *Mohanpura Tea Co.'s Case* (1937 I.T.R. 118) in which that High Court held that in the case of tea grown in a Native State and sold in British India the entire income was assessable in British India. The Madras High Court is of opinion (i) that the Calcutta case was not correctly decided and does not give full effect to the decision of the Judicial Committee in *Kirk's Case* (1900 A.C. 588); (ii) that Clauses (1) and (2) of Section 4 are not mutually exclusive; (iii) what was done to the raw coffee to make it marketable in British India was only an agricultural process and no part of it could be attributed to manufacture or business; (iv) receipt of produce in kind in Mysore was receipt of money's worth and therefore receipt of income. The Madras High Court has got over an anomalous situation created by the carelessness of the legislature in inserting the proviso to Section 4 (2) in an inappropriate place but some of the propositions laid down in this case (especially the proposition that there is a receipt of income as soon as agricultural produce is received even before it is sold) require careful consideration. The case will be discussed in detail as soon as the full text of the judgment is available.

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VOL. V, PART VI.

NOTES & COMMENTS.

THE JUDICIAL COMMITTEE ON BUSINESS EXPENDITURE: TATA HYDRO-ELECTRIC AGENCIES' CASE.

THE RULE IN THE PONDICHERRY CASE.

It was laid down by the Judicial Committee in the *Pondicherry Case* (58 I.A 239; 54 Mad. 691) that "a payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits. It assumes that profits must come into existence. But profits on their coming into existence attract tax at that point and the revenue is not concerned with the subsequent application of the profits." This principle was re-affirmed and applied by the Committee in *Bharat Insurance Company's Case* (1934 I.T R. 63; 61 I.A. 41).

SCOPE OF THE RULE EXPLAINED.

The recent decision of the Judicial Committee in the *Tata Hydro-Electric Agencies' Case* (reported below at p. 202) shows that the true scope of this rule has been much misunderstood in India and that the rule has been applied in several instances to cases which do not fall within it. In this case LORD MACMILLAN who enunciated the rule in the *Pondicherry Case* has himself explained the real scope of the rule. The noble Lord has pointed out in clear and emphatic terms that rule in the *Pondicherry Case* is confined to payment out of *profits*. Payment of a share in a particular item of income is not within the rule even though the income in question is taken into computation in determining the total income assessable to income-tax. In the case in question Tata Sons, Ltd., who were the Managing Agents of the Tata Power Co. Ltd., and of some other hydro-electric companies were entitled to receive 10% of the profits of the Tata Power Co. Ltd., as remuneration for services rendered as Managing Agents. Tata Sons, Ltd., agreed with two other persons, in consideration of the latter

advancing money to the Tata Power Co. Ltd., to pay 25% of their commission to each of these financiers. Tata Sons Ltd. subsequently assigned their managing agency rights to the Tata Hydro-Electric Agencies Ltd., and the latter renewed the agreements with the financiers and paid them 12½% each in accordance with a covenant they had entered into with Tata Sons Ltd. The income-tax authorities of India and the High Court of Bombay held that the case was clearly governed by the *Pondicherry Case* and the 25% paid by Tata Hydro-Electric Agencies Ltd., could not be deducted as business expenditure in computing their income for purposes of income-tax as it was a payment of a share of their profits.

A Fundamental Distinction.

Lord Macmillan, in delivering the judgment of the Board, pointed out that there is a fundamental distinction between a payment of a share of the profits and a payment of a share in a particular income which is only an item or factor in the computation of a person's profits or gains. The noble Lord said:

"Before their Lordships, Counsel for the Crown did not seek to support the judgment of the High Court in the present case on the ground that it was ruled by the decision in the *Pondicherry Case* and in their Lordships' view he was well advised in recognising the clear distinction between that case and the present case. In the *Pondicherry Case* the assessees were under obligation to make over a share of their profits to the French Government. Profits had first to be earned and ascertained before any sharing took place. Here the obligation of the appellants to pay a quarter of the commission which they receive from the Tata Power Co. Ltd., to F.E. Dinshaw Ltd., and Richard Tilden Smith's administrator is quite independent of whether the appellants make any profit or not. Indeed, if on their year's operation as a whole they were to make a loss and incur no liability to income-tax, they would nevertheless have to pay away a quarter of the commission in question to the parties named. The commission in truth is not profit or gain: it is only an item or factor in the computation of the appellant's profits or gains. Their Lordships regard this as a fundamental distinction."

Again at p. 208 his Lordship said:

"It was not questioned by Counsel for the Crown that if the present question had arisen with Tata Sons, Ltd., they would under Section 10 (2) (ix), have been entitled on the facts stated to deduct their payments to F.E. Dinshaw, Ltd., and Richard

Tilden Smith as being expenditure incurred solely for the purpose of earning their profits or gains."

Macdonald & Co.'s Case Disapproved.

With reference to *C. Macdonald & Co.'s Case* [1935 3 I.T.R. 459] which the Bombay High Court purported to follow, and in which case also the said High Court had applied the rule in the *Pondicherry Case* their Lordships say that it cannot be supported by the authotity of the *Pondicherry Case.*

Payments Made By Purchaser of Business.

The actual decision in *Tata Hydro-Electric Agencies' Case* is based upon another important principle which has also to be kept in mind in this connection. It is this :—

"If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of the business; and it would make no difference that the annual sum should be made payable out of a particular receipt of the business irrespective of the earning of any profit from the business as a whole ". In such a case the payments would assume a different character in the hands of the purchaser. They would not be payments made in the process of earning profits but would be payments made in fulfilment of an obligation undertaken by the purchaser in consideration of his acquisition of the right and opportunity to earn profits, *i.e.*, of the right to conduct the business and not for the purpose of producing profits in the conduct of the business.

How to Avoid this Hardship.

Now that the Judicial Committee have laid down that what was business expenditure and an admissible deduction would cease to be such in the hands of the purchaser who makes the same payments in fulfilment of a covenant entered into with the original owner, prudent businessmen should begin to consider how this hardship—it is really one of the pitfalls of the law of income tax—can be avoided. It is the fact that the payment is made in fulfilment of an obligation undertaken as consideration for the acquisition of the right to conduct the business that makes the whole difference. It is therefore doubtful whether the same result would follow if the purchaser does not enter into any such covenant with the vendor but merely goes on paying, as the vendor did, to earn his profits; and we think it is clear that if the debt due to the third

party is entirely discharged by the vendor and the agreement between them terminated, and the purchaser himself directly enters into another transaction, though with the same parties and on the same terms, the purchaser would be in the same position as his vendor and would be entitled to claim a deduction.

Though the judgment of the Bombay High Court in the *Tata Hydro Electric Agencies' Case* has been affirmed by the Judicial Committee, the grounds on which the judgment has been affirmed are entirely different. This judgment of the Judicial Committee has in fact saved India from an interpretation of the *Pondicherry Case* which would have caused much miscarriage of justice and reminds us of the other similar instances in which the noble Law Lords of the Judicial Committee have, with their clearness of perception, unerring knowledge of fundamental principles and inborn sense of justice rendered invaluable service to India.

Official Assignee's Liability to Pay Income Tax on Insolvent's Property.

The interesting question whether the Official Assignee is liable to pay income tax on the income of property of an insolvent which becomes vested in him on an adjudication in insolvency was recently decided by the Calcutta High Court in *In the matter of the Official Assignee for Bengal* (reported at page 233 infra). On the adjudication of a person, certain house property which belonged to him vested in the Official Assignee. The Income Tax Officer called upon him to make a return of the income from the property. The Official Assignee declined to do so stating that no statement of income in an insolvent estate could be rendered and that all he could do in the matter was to send a statement of the deficiency account as disclosed in the schedule of affairs filed by the insolvent. The Income Tax Officer thereupon made a best judgment assessment on him under Section 23 (4). The Commissioner referred the matter to the High Court under Section 66 (1). It was argued by Mr. Page on behalf of the Official Assignee that the property changed its character when it passed into the hands of the Official Assignee, and that, although it would have been a fit subject matter for assessment of income tax in the hands of its original owner, yet when it passed into the hands of the Official Assignee the property ceased to have the same taxable quality and was no longer a fit subject for taxation.

Their Lordships however did not agree. In their view *vis-a-vis* the revenue there was no change of character whatever. They

further held that the Official Assignee was the 'owner' of the property within the meaning of Sec. 9 of the Indian Income Tax Act, that the income was the income of the Official Assignee for the purposes of income tax, and that he could rightly be assessed under Sec. 9 of the Income Tax Act.

COMMISSION PAID OUTSIDE BRITISH INDIA TO FOREIGNERS SERVING IN INDIA, WHETHER ACCRUES OR ARISES IN INDIA.

The question where income accrues or arises has been the subject of several decisions and though many eminent Judges have expressed their views on the subject, it still remains one of the most intricate questions of income tax law. The recent Judgment of the Calcutta High Court in the case of *V. G. Every* (reported below at page 216) contains a very learned discussion of the subject. The determination of the question where income accrues is so difficult that one would certainly welcome the shelter contained in the statement made by Mr. Justice Costello in this case that " the question should be looked at in the light of common sense and plain thinking and not too much importance should be attached to or emphasis laid upon the niceties of verbal definitions." But usually, we remember the path of common sense and plain thinking only after we get exhausted in the labyrinths of principles and precedents.

THE DECISION IN MR. EVERY'S CASE.

A company registered in England owned some tea estates in Assam in British India. Mr. Every entered into an agreement to serve the company for four years in the cultivation and manufacture of tea in these estates on a salary of Rs. 800 per month and five per cent. commission on the net profits earned by these estates. During the accounting year 1934–35 he was on leave for seven months and while on leave in the United Kingdom he received Rs. 6,905 being the commission earned by him during the year 1933–34 on the basis of the profits of the company for the year 1932. The question being whether this sum of Rs. 6,965 accrued or arose in British India or in the United Kingdom, their Lordships held that although the commission was payable in a lump sum after the accounts of the company had been made up, the commission must nevertheless in the circumstances of the case be treated as if it were pay or salary paid upon a monthly footing and that it was obviously right and proper in the circumstances of the case to hold that the income in question did accrue or arise in British India.

MEANING OF 'ACCRUE OR ARISE.'

Their Lordships' opinion on the legal points involved is this :—

(1) The words 'accruing or arising' in Section 4 (1) of the Income Tax Act mean something different from 'received.'

(2) They indicate some origin or source of growth for the income in question. On this point they agree with the decisions of the Bombay High Court in *Bansilal Motilal's Case* (54 Bom. 460) and *Sarupchand Hukumchand's Case* (55 Bom. 241)

(3) The place where income is earned is not necessarily the place where it accrues or arises (PANCKRIDGE, J.).

In our view their Lordships are right in their conclusion, on the facts, that the income in question accrued or arose in British India. Propositions 1 and 2 mentioned above are also right but we do not agree that the words 'accrue or arise' necessarily indicate the origin or source of growth of the income in question. Income may accrue or arise at a place which is entirely different from the origin or source of growth of the income.

'Accruing or arising' in our opinion, refers to a stage anterior, in legal conception, to the receipt of the income, though the two stages may in certain cases occur at the same place or at the same time. Accrual denotes the stage at which the title of the assessee to the income becomes perfect. The difference between 'accruing or arising' and 'receiving' is, we think, similar to the difference between 'ownership' and 'possession' which is so well known in law. When a person comes to 'own' a particular item of income, *i.e.*, when his title to the same becomes a settled and acknowledged fact, it accrues to him. When he takes possession of it, he 'receives' it. 'Accrue or arise' denote therefore an earlier stage and 'receive' a later, in fact the last, stage. This matter requires more elaboration and we shall deal with this subject shortly in greater detail and review the various theories that have been advanced in the decided cases.

NOTIFICATIONS OF THE CENTRAL BOARD OF REVENUE.

The Central Board of Revenue have issued the following notifications under Sec. 60 of the Indian Income Tax Act :—

NOTIFICATION No. 16 (May 1, 1937).

No. 16—In exercise of the powers conferred by Section 60 of the Indian Income tax Act, 1922 (XI of 1922) the Central Government are pleased to direct that the following further amendments shall be made in the notification of the Government of India, in the Finance Department (Central Revenue), No. F-72 I.T. 25, dated the 16th April 1925, namely :—

In the said notification—

(1) For the word "Government" the following shall be substituted, namely :—

"the Central Government, the Crown Representative or the Provincial Government as the case may be,"

(2) In the *List of Officers* appended to the said notification, for the entries "The Andaman and Nicobar Islands, Aden" and "any first class Resident in the Political Department" the following entries shall, respectively be substituted, namely—

"The Andaman and Nicobar Islands" and "any first class Resident of the Indian Political Service."

NOTIFICATION No. 17.

No. 17—In exercise of the powers conferred by Section 60 of the Indian Income-tax Act, 1922 (XI of 1922) and in supersession of the Notification of the Government of India in the Finance Department (Central Revenues) No. 21, Income-tax, dated the 28th July 1934, the Central Government are pleased to exempt from the tax payable under the said Act the income of a Service Fund derived from interest on Government securities or interest on funds deposited with the Central or any Provincial Government.

For the purpose of this exemption, a Service Fund means a fund established under the authority of, or with the permission of, the Central or any Provincial Government for the purpose of securing deferred annuities to the subscribers, or payments to them in the event of their resignation or dismissal from the service in which they are employed, or provision for their wives or children after their death or payments to their estates or their

nominees upon their death, to which servants of the Crown are alone admissible as subscribers or members and the funds of which are either deposited with the Central or any Provincial Government or invested in Government Securities.

NOTIFICATION No. 18.

No. 18—In exercise of the powers conferred by Section 60 of the Indian Income-tax Act, 1922 (XI of 1922), the Central Government are pleased to direct that the following further amendment shall be made in the notification of the Government of India in the Finance Department No. 873-F., dated the 21st March, 1922, namely:—

In sub-clause (a) of clause (9-C) of paragraph (a) of the said Notification for the words "Agent to the Governor-General in" the words "Resident for" shall be substituted.

AN AMENDMENT TO THE INCOME TAX ACT.

The Repealing and Amending Act (XX of 1937) which came into force on the 14th April, 1937 contains a small amendment to the Indian Income Act, 1922, to the following effect: "In sub-Section (2) of Section 30, after the words "intimation of the refusal,' the words, brackets, figures and letter "to pass an order under Sub-Section (1) of Section 25-A, or" shall be inserted.

The amendment is a formal one consequential on the insertion of a reference to Section 25-A in sub-Section (1) of Section 30 of the Act.

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NOTES AND COMMENTS.

BUSINESS EXPENDITURE: PONDICHERRY CASE FURTHER EXPLAINED.

THE PONDICHERRY CASE.

The statement made by LORD MACMILLAN in the *Pondicherry case* that 'a payment out of profits and conditional on profits being earned cannot accurately be described as an expenditure incurred to earn profits' which was understood in India as laying down a rule of law, was recently explained by the Judicial Committee in the *Tata Hydro-Electric Agencies case* (1937 I.T.R. 203). Their Lordships pointed out in this case that there is a fundamental distinction between a payment of a share in a particular receipt or item of income and a payment out of profits and that the observations of LORD MACMILLAN in the *Pondicherry case* were not intended to cover payments out of particular items of income. It was also pointed out that the *Pondicherry case* was not rightly understood and applied by the Indian High Courts in the judgment appealed from (1936 I.T.R. 92) and in *Macdonald's case* (1935 I.T.R. 459).

INDIAN RADIO AND CABLE COMMUNICATIONS CO.'S CASE.

The judgment of the Judicial Committee in the *Indian Radio and Cable Communications Co. Ltd.* v. *Commissioner of Income Tax, Bombay* (decided on the 8th of April and reported at page 270 *infra*) contains a clear pronouncement that there is no such invariable rule of law at all. Their Lordships expressly state in this case that 'it is not universally true to say that a payment the making of which is conditional on profits being earned cannot properly be described as an expenditure incurred for the purpose of earning such profits', and refer as a typical exception to a payment to a director or manager of a commission on the profits of a company. As LORD MAUGHAM has rightly observed, an apparent difficulty here is really caused by using

the word 'profits' in more than one sense. If a company having made an apparent net profit of £10,000 has then to pay £1,000 for directors or managers as the contractual recompense for their service during this year it is plain that the real net profit is only £9,000. A contract to pay a commission at 10% on the net profits of the year must necessarily be held to mean on the net profits before the deduction of the commission, *i.e.*, in the case supposed, a commission on the £10,000.

A HOUSE OF CARDS.

The pronouncement is clear authority for the proposition that a payment which is made out of profits and conditional on profits being earned may yet be expenditure incurred for earning such profits and allowable as such. The real question is, as in other cases of business expenditure, whether the expenditure was really incurred for the purpose of earning profits. The fact that the payment is a share of the profits and is conditional on profits being earned does not affect the question. The big edifice which the revenue authorities and High Courts of India had built on the observations of LORD MACMILLAN in the *Pondicherry case* has at last crumbled down like a house of cards.

DECISION IN THE INDIAN RADIO CO.'S CASE

The actual decision in the *Indian Radio and Cable Communications Co.'s case* brings into clear relief the distinction between agreements in the nature of leases and agreements which evidence joint adventures. If an agreement is of the character of a lease the amounts paid to the lessor will be rent and allowable as such but if the case is really one of a joint venture there is only a division of profits between the partners, and the amounts paid to the owner of the premises or machinery cannot be deducted as business expenditure. Those who enter into agreements for working factories or other concerns owned by others would do well to remember this distinction in drafting their agreements.

DEFERRING DRAWING OF SALARY TO AVOID HIGHER RATE OF TAX.

There is an interesting case of successful evasion of income tax in *Banke Bihari Lal* v. *Commissioner of Income Tax, Punjab and N.W.F.P.* (decided by the Lahore High Court on April 28), and persons who find themselves in the position of the assessee

in the above-mentioned case may perhaps safely take advantage of the procedure adopted by the assessee in this case.

The assessee was an Assistant Superintendant in the Office of the Auditor General. His monthly pay during the year of account, was Rs. 427-8-0 and his pay for twelve months would accordingly amount to Rs. 5,130. He wrote to the head of his office to pay him his February salary on the 1st of April instead of on the 1st of March so that his total income for the year of account may be less than Rs. 5,000 and the disbursing officer complied with his request. Thus the actual amount received by the assessee in the year of account was less than Rs. 5,000, but if the February salary which was payable on the 1st of March was also included, his income would have exceeded Rs. 5,000.

The income tax authorities included the salary of February also in computing the total income of the assessee on the ground that it was drawn in March by the disbursing officer and must be regarded as having been paid to the assessee in that month. They took the view that this amount must be treated as having been held by the head of the office in trust for the assessee until it was actually paid over to him. The High Court held that there was no reason why the head of the office in such circumstance should be treated as a bailee or trustee, that income tax is to be assessed upon salary with reference to time at which it is actually received by the employee and that the income tax authorities acted wrongly in including the February salary in computing the total assessable income of the assessee.

Recommendation of the Enquiry Committee.

The Income Tax Enquiry Committee have made some recommendations to prevent this kind of avoidance of tax. They say: " It has been brought to our notice that the existing basis of assessment, *viz.*, remuneration actually received in the previous year leads to an anomalous position as it is possible for an assessee in some circumstances so to arrange matters by anticipation or deferment of the drawing of the remuneration due to him as to affect in his favour the rate of tax applicable to his income for a particular year. This anomaly is most striking in the case where an assessee defers the drawing of his pay in order that it shall be received in a subsequent year, when by reason of his being on leave his rate of tax is much lower than usual. The effect of such action will be partially remedied if our recommendation in Chapter I, Sec. 5, for the taxing of leave pay is adopted. Further

if the slab system of rates of tax be adopted the defect would partly disappear since no longer would an addition to the total income of the year affect the rate of tax chargeable upon the whole of that income. There are other cases, for example, (a) deferring remuneration of the penultimate year of service and drawing it in the final year when remuneration is less than for a full year, (b) drawing only part of commission in a year when it is abnormally high, and (c) taking loans in lieu of salary. To meet this type of avoidance it is recommended that Sec. 7 of the Act be amended so that liability may be based upon the remuneration *due* in a year which however would make no difference to the tax payable in the normal case." There is also a note to the Report that the word '*due*' in this recommendation is intended to refer to the date on which remuneration becomes payable and has no reference to period *for* which it was earned.

SOUNDNESS OF THE RECOMMENDATION.

No doubt the recommendation made by the Committee that liability may be based upon the remuneration *due* in a year may prevent avoidance of tax in case like the present, but we think the recommendation should not be adopted by the Legislature as it is inconsistent with the fundamental principle relating to income tax, especially Indian income tax, that tax should be levied only on income which has 'accrued, arisen or received': (See Section 3). Imposing of tax on salary or commission which has merely become due would lead to taxation, in many cases, of salary or commission which may not be paid at all to the assessee. To prevent a few trivial cases of avoidance we would be introducing a principle which would operate unjustly in the case of innumerable assessees who have not received their salary or commission and may not receive them at all.

PROFITS DERIVED FROM SALE OF SECURITIES

Businessmen have often to invest money in securities and when they sell these securities at a profit the question arises whether the profit so earned is an accretion to capital or income. In the former case it cannot be assessed to income-tax but in the latter case it can be assessed. The recent decision of the Lahore High Court in *Amritsar Produce Exchange, In re*, [1937 I.T.R. 302] lays down, what appears to be the correct principle to be applied to such cases. The learned Judges have stated in this case after a consideration of the earlier authorities on the subject that it cannot be laid down as a rule of general

application that in every case an investment in the shape of security made by a concern should be treated as fixed capital. It has to be determined on the facts of each case whether the investment was a part of the ordinary business of the investor or otherwise. If it could be found that an investment has been made for the purpose of permanently excluding a certain sum from the floating capital of a concern it might be permissible to hold that that sum was intended to serve as a reserve or, in other words, as fixed capital having no concern with the stock in trade. If, on the other hand, the facts relating to that investment unequivocally point to the conclusion that the investment is to all intents and purposes a part of the business and that the sum so invested is intended to serve as stock in trade the profits arising therefrom will form part of the income of the concern.

A Point for Assessees to Note.

The learned Judges say that it is the intention of the assessee that is to be considered, and if it is found by the department as a matter of fact that the assessee's intention was to make profits from these investments as a part of the assessee's business it is doubtful whether the High Court will go behind that finding. It is therefore of the utmost importance that when an investment in securities is made by persons carrying on business, the accounts should clearly show whether these investments are made in the course of the business or only as an investment of fixed capital. If assessees do not take care to see that there is sufficient evidence, documentary or otherwise, to prove that their intention in making the investment is merely to invest their fixed capital they may find themselves liable to pay income tax on what after all is only an increase of capital.

The recent case of *Sir Chinubhai Madhowalal* v. *Commissioner of Income Tax, Bombay* (1937 I.T.R. 210) also throws some light on this question. Their Lordships have observed in this case that because a man has a business of money-lending it does not follow that every single transaction which he enters into which involves the lending of money must be taken as part of the money-lending business. A money-lender like other people may invest his capital or accumulated profits in forms of investments which are in law loans for example Government or municipal loans, mortgages and debentures and if he invests in such a manner and suffers a loss on the investment the loss is a loss of capital and cannot be set off against the profits or gains. In this case it was found that the debent-

ures in question which the assessee had acquired were not taken as part of the money-lending business of the assessee and he was not allowed to set off the loss suffered by the investment on the debentures, against the profits and gains of his money-lending business.

BAD DEBTS.

In the *British Cotton Growers' Association (Punjab) Ltd.* v. *Commissioner of Income Tax, Punjab*, [1937 I.T.R. 279] we find one more decision of the Lahore High Court on 'bad debts'. We have already observed on several previous occasions that though the Privy Council have made some pronouncements on the subject in the case of *Sir S.M. Chitnavis* the question when a debt becomes bad, is, as the law at present stands, an extremely difficult one and assessees have been put to much inconvenience and hardship by the uncertainty of the law on the subject. The case in hand is also an instance which shows the necessity of framing more definite rules on the subject.

Further, the Lahore High Court has observed in this case that "so long as there is any ray of hope left to recover a debt, however dim it may be, and so long as a debt is in the process of realisation it cannot be said that it has become irrecoverable". We doubt whether this broad statement is consistent with the opinion of the Judicial Committee in *Sir S.M. Chitnavis' Case.* It is not clear whether the hope referred to is the hope in the minds of the creditor. If this is so, this observation of the Lahore High Court is in conflict with the opinion of the Judicial Committee that whether a debt has become bad and when it becomes bad is a matter to be decided by the appropriate tribunal on all the facts of the case.

As we had stated before, *the confusion on the subject is sure to increase day by day until the income tax authorities and the Court begin to realise that an honest decision of the creditor as to when and whether a debt due to him has become bad or doubtful should be accepted and acted upon.*

We are glad to find that the Income tax Enquiry Committee have recognised that there is general dissatisfaction in every province visited, regarding the treatment of bad debts and that the "treatment of bad debts claims is one of the principal causes for the existing dissatisfaction with the income tax department," and it is a source of some gratification to us to find that they have adopted, to some extent though not fully, the principle which we have

been insisting on for the last three years, for, we find that the Committee have made the recommendation that

"the instructions in the Manual for the guidance of Income Tax Officers should be amended so as to make it clear that the assessee's estimate in the case of doubtful debts and the year for which allowance is to be claimed should only be challenged for adequate reasons".

We think however that the proper place for inserting a provision of this kind is in the Act itself and not in the Manual.

We would invite the attention of the readers in this connection to p. 56 of our Notes and Comments in Vol. III of the *Income Tax Reports* and p. 52 of Vol. IV of the Reports where we stated our view on the subject in these terms :—" No one can specify the exact point of time when a debt becomes bad. The financial stability of a debtor often changes gradually and imperceptibly. When a debt becomes bad is really a *matter of opinion and the opinion of the creditor must be respected and acted upon* by the income tax authorities and the Courts unless it is proved to be capricious or *mala fide*".

Personal Remarks on Subordinate Officers.

We are much pained to find that sometimes personal remarks are made by Commissioners against their subordinate officers in orders of reference made to the High Court. Does not fairness and decency require that such remarks should be avoided in orders of reference and reserved for departmental files? Should not the Commissioners jealously guard and maintain the dignity and prestige of their subordinate officers in the eyes of the public?

Mercantile System of Accounting and Assessment of Unrealised Interest.

Notwithstanding one or two decisions to the contrary, the weight of authority is now clearly in favour of the view that if an assessee keeps his accounts in the mercantile system he can be assessed on interest as it falls due, even though it has not been received by the assessee. The Lahore High Court has recently re-iterated this view in the *B.C.G.A. (Punjab) Ltd* v. *Commissioner of Income Tax, Punjab* (reported at page 279 infra). The danger of having to pay income tax on interest which has not yet been received, with the hope of subsequently claiming as bad debt such portion of the interest as is not realised, is obvious and has been adverted to by us more than once.

Adopting Vernacular Year for Head Office and Financial Year for Branch Offices.

Though the law as it stands, read in the light of the instructions contained in the Income Tax Manual, permits an assessee to adopt the vernacular year for his head office and the financial year for the branches, this procedure often gives rise to unexpected complications. *Mela Mal Shiv Dayal* v. *Commissioner of Income Tax, Punjab* (to be reported in the next issue) is an instance in which an assessee who adopted this method had to suffer. He kept the account of his head office according to the *sambat* year and of the branch offices according to the financial year. The *sambat* year 1930-31 ended on the 19th of March, and the financial year 1930-31 ended on 31st March, 1931. He incurred some losses in the branch offices in 1930-31 but as the accounts of the branches were made up only on the 31st March these losses were not claimed in his assessment for the *sambat* year 1930-31. He sought to have them set off in the next *sambat* year which ended on the 5th of April 1932, but was not allowed to do so on the ground that he was not entitled to accumulate the results of two years' accounts and claim them in one year's assessment.

We wonder what the position will be if there had been a profit in the branches for both the years instead of loss.

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HINDU FAMILY CONSISTING OF SOLE SURVIVING MALE MEMBER AND FEMALE MEMBERS.

The vexed question whether, when all the male members of a Hindu undivided family except one die, the income received by right of survivorship by the sole surviving male member is to be taxed in the hands of such male member as his own individual income or as the income of a Hindu undivided family has been set at rest by the decision of the Judicial Committee in *Commissioner of Income Tax, Bombay* v. *Swamy Gomedalli* (to be reported). In this case the Bombay High Court had decided (Vide 1935 I.T.R. 367) that the income in such cases is still the income of a Hindu undivided family, but the Privy Council has, following their recent decision in *Kalyanji Vithaldas's Case* [1937 I. T. R. 90), reversed the judgment of the Bombay High Court and held that such income can be taxed as the individual income of the sole surviving member for purposes of assessment to super tax. The learned counsel who appeared for the assessee in the case argued that the principle of *Kalyanji Vithaldas's Case* does not apply to cases like the present one, but their Lordships have held otherwise.

The decision is sure to cause some hardship as courts are now very liberal in allowing maintenance to widows of coparceners and even allow as maintenance as much of the income as would have gone to the deceased coparceners' shares if they had lived, and as the sole surviving member may further have to defray the marriage expenses of the daughters of deceased coparceners out of the income which he receives and to set apart a residence for the widow. The decision of the Judicial Committee is however final and there is no use of adverting to such matters any further.

ASSESSMENT OF INSURANCE COMPANIES.

A question of general importance relating to assessment of insurance companies, Indian and Non-Indian, has been recently decided by the Calcutta High Court in the case of the *North British and Mercantile Insurance Co., In re*, and the *Phoenix Assurance Co., In re*, reported at pp. 349 and 397 below. Ascertainment of the income of insurance companies is a matter of great difficulty and the Government have therefore by Rules framed under the Indian Income Tax Act, prescribed an arbitrary, though convenient, method of computing the assessable income of such companies. Rule 25 of the Income Tax Rules provides:

"In the case of life assurance companies incorporated in British India whose profits are periodically ascertained by actuarial valuation the income, profits and gains of the life assurance business shall be the average annual net profits disclosed by the last preceding valuation, provided that any deductions made from the gross income in arriving at the actuarial valuation which are not admissible for the purpose of income tax assessment and any Indian income tax deducted from or paid on income derived from investments before such income is received shall be added to the net profits disclosed by the valuation."

And Rule 35 provides:—

"The total income of the Indian branches of non-resident insurance companies (life, marine, fire, accident, burglary, fidelity guarantee etc.) in the absence of more reliable data may be deemed to be the proportion of the total income, profits or gains of the companies corresponding to the proportion which their Indian premium income bears to their total income. For the purpose of this rule the total income, profits or gains of non-resident life assurance companies whose profits are periodically ascertained by actuarial valuation shall be computed in the same manner as is prescribed in Rule 25 for the computation of income, profits and gains of life assurance companies incorporated in British India."

The fact that the income of such companies often includes interest on securities which are declared tax-free and that income tax is deducted at source in the case of other securities gives rise to two important questions, *viz.*, (1) whether where income tax is charged on the income of an insurance company as ascertained under these rules, the company can claim credit under S. 18 (5) of the Indian Income Tax Act for any deduction of tax made at the

source; and (2) whether when the profits of a life assurance company have been ascertained under Rules 25 and 35 the company is entitled to claim that from the amount thus ascertained so much of the income, profits and gains of the company as are due to interest on tax-free securities should be deducted in computing the assessable income.

These two questions were referred to the High Court of Calcutta by the Commissioner of Income Tax, Bengal, in the above mentioned cases. After hearing elaborate arguments the High Court (*Sir Harold Derbyshire, C.J.*, *Costello, J.*, and *Panckridge, J.*) unanimously answered the first question in the affirmative, and it may therefore be taken as settled law that the company can claim credit for income tax deducted at the source.

The second question has given rise to a conflict of judicial opinion. THE CHIEF JUSTICE and MR. JUSTICE COSTELLO have held in favour of the company, that is to say, they are of opinion that the company is entitled to claim that from the taxable income ascertained in accordance with the rules so much of the income as is due to interest on tax-free securities should be deducted, as otherwise the authorities would in effect be taxing income that has been declared to be tax free. The Rules cannot exclude the operation of the definite and unequivocal provisions contained in Section 18 (5) of the Act. PANCKRIDGE, J., upholding the view of the Commissioner, holds that Rules 25 and 35 prescribe an empirical method for ascertaining the income of an insurance company and the notional figure arrived at by applying the Rules cannot be further analysed and dissected. It is not open to the authorities to inquire whether any portion of this figure represents income from tax-free securities and to deduct any portion of such figure from the assessable income. The view of the majority has, of course, prevailed and we have to be guided by this view in assessing insurance companies.

As COSTELLO, J., has observed the question is one of some complexity and difficulty and the matter is not free from doubt; as the rules now stand there is much to be said in favour of PANCKRIDGE, J.'s view and we cannot be quite sure that the Judicial Committee will uphold the view of the majority.

As the Income Tax Act is being revised Insurance Companies should lose no time in bringing this matter to the notice of the Central Board of Revenue. Specific provisions should be inserted in the Act itself or the Rules to remove the apparent inconsistency that at present exists between the Act and the Rules.

Assistant Commissioner's Power to Admit Additional Grounds of Appeal—II.

LAHORE VIEW (*Ram Rakha Mal's Case*).

The Lahore High Court had expressed in *Ram Rakha Mal's Case* (1937 I.T.R. 137) the opinion that 'an Assistant Commissioner has no authority to admit a new matter raised in the form of an additional ground of appeal after an appeal has once been admitted, whether within the period prescribed therefor or after its expiry. All that he can do under this enabling provision [Sec. 30 (2)] is to admit an appeal for the first time even if it is presented after the period prescribed therefor.'

In commenting upon this case (*vide* 1937 I.T.R. Notes and Comments pp. 34-35), after referring to the argument upon which their Lordships had based this conclusion, we said that with all respect we find it difficult to appreciate the force of this argument and suggested that the proposition laid down by their Lordships should be reconsidered.

OUDH CHIEF COURT TAKES THE RIGHT VIEW.

We are much gratified to find that in a very recent case decided on the 7th of May (*Commissioner of Income Tax, U. P. and C. P.* v. *Behari Lall-Ramchandra*), the Oudh Chief Court has taken what in our opinion is the correct view. In this case the Assistant Commissioner refused to admit certain additional grounds of appeal on the ground that an application for filing additional grounds of appeal is governed by the 30 days' rule of limitation laid down in Section 30 (2) of the Act. Referring to this view their Lordships said:—

"We are definitely of opinion that this view is incorrect. In the present case the original appeal was admittedly filed within the prescribed period of limitation. The law does not contemplate two appeals against the same order. One appeal having already been filed, the application for the consideration of additional grounds of appeal cannot in any sense be regarded as an appeal governed by the rule of limitation laid down in Section 39. There is no rule of limitation prescribed for filing additional grounds. Such grounds date back to the date of the original appeal, of which when admitted, they become a part. The additional grounds of appeal can therefore be filed at any time before the appeal is decided. The Assistant Commissioner was, therefore, quite wrong

in holding that the additional grounds could not be allowed to be raised after the period prescribed for the filing of the appeal had expired."

ARBITRARY EXERCISE OF DISCRETION CAN BE REVISED.

The Oudh Chief Court has further held in this case that an improper exercise of discretion in rejecting additional grounds can be corrected by the High Court. After referring to the considerations lending support to the argument that an assessee could as a matter of right raise additional grounds at any time before the hearing of the appeal, the learned judges say:—

"Even if this is not so, we have no doubt that the Assistant Commissioner could admit the additional grounds in the exercise of his discretion. It is also a rule of general law that when a Court is allowed discretion in any matter, the discretion must be exercised in a judicial manner, and not capriciously or arbitrarily. It is also well settled that the proper or improper exercise of discretion is a question of law. If therefore the Assistant Commissioner has exercised his discretion in refusing to entertain the additional grounds in an improper manner, the discretion must be open to correction."

If 'improper' exercise of discretion is read as meaning arbitrary or perverse exercise of discretion amounting to a failure to exercise *discretion*, the statement of law contained in this passage is unobjectionable.

FOREIGN BUSINESS: LOSS ON EXCHANGE, WHETHER CAPITAL LOSS.

When an assessee residing in British India carries on money-lending business outside British India or a money-lending firm has branches outside British India, and in remitting moneys to or from the foreign place of business loss is incurred on account of the rate of exchange, is the assessee entitled to have this loss deducted in computing the profits of the foreign business? This question was recently considered by a Special Bench of the Rangoon High Court in *Commissioner of Income Tax, Burma* v. *A. S. Concern, Bassein* (to be reported shortly) and answered in the affirmative. LEACH, J., who delivered the leading judgment said:

"When she (the assessee) sent the money to Saigon to be utilised there in the course of her business she had of necessity

to change the rupees into dollars and when she wished to bring back the money she had to change the dollars into rupees. The rate of exchange was an important factor. An adverse exchange meant loss of profit to her: a favourable exchange meant more profit. It is impossible to make a true estimate of the assessee's profits of the Saigon business without taking into consideration what she lost or gained on the rate of exchange."

Their Lordships ultimately held that the loss on exchange in such cases is not a loss of capital.

Non-Residents: "Business Connection," Explained.

The principle laid down by the Judicial Committee in *Currimbhoy Ebrahim and Son's case* [1934 I.T.R. 148] that the mere lending of money to a person within British India does not create a 'business connection' between the lender and the borrower so as to enable the income-tax authorities to assess the interest earned by the non-resident lender as income arising to him though a business connection in British India within the meaning of Section 42 (1) of the Indian Income-tax Act, is further explained and applied in a recent case decided by the Rangoon High Court, *Commissioner of Income Tax, Burma* v. *Visalakshi Achi* (to be reported shortly). The assessee who resided at Puthukootta (outside British India) made some loans to persons residing or carrying on business in British India and earned interest on such loans. It was contended that when a person carries on the business of lending money each loan emanates from a business connection with the borrower. Their Lordships repelled this contention saying that 'business connection' did not mean 'business transaction,' and held that as there was no course of dealing between the assessee and these particular borrowers 'such as might fairly be described as a business previously subsisting between them' there was no business connection between the assessee and the borrowers. The mere lending of money purely as a loan to a person does not establish a business connection with that person, even though the latter carries on a business. This decision further establishes that the fact that the lender carries on a money-lending business does not necessarily create any 'business connection' between him and his borrower and that the principle of *Currimbhoy Ebrahim's case* does not cease to be applicable merely because the lender carries on a money-lending business.

"BUSINESS CONNECTION DEFINED'

MR. JUSTICE MACKNEY defines business connection in these words:

"The word 'business' must therefore have the significance indicated in Sec. 2 (4) of the Act and denote an adventure or concern in the nature of trade, commerce or manufacture. The word 'connection' must be used in the sense of 'that with which one is connected,' so that in order to make clear the meaning of the expression 'any business connection' we may expand it thus: "Any adventure or concern in the nature of trade, commerce or manufacture being a business with which he (that is the person residing out of British India) is connected."

COMMISSIONER'S POWER TO DISMISS INCOME TAX OFFICERS.

NEELAMEGHAM PILLAI'S CASE.

The recent decision of the Madras High Court in *Neelamegham Pillai* v. *Secretary of State for India* (to be reported shortly) throws much light on the powers and duties of Commissioners of Income Tax in the matter of appointment and dismissal of Assistant Commissioners and Income-Tax Officers and on the remedies of dismissed officers. An Income Tax Officer who was dismissed by the Commissioner of Income Tax, Madras, instituted a suit against the Secretary of State for India in Council for damages contending that his dismissal was illegal and void inasmuch as (i) the Commissioner did not hold a proper enquiry as contemplated by the Rules and (ii) because the Commissioner had not obtained the previous approval of the Government.

THE DECISION.

The High Court held that even assuming that the procedure prescribed by Rules had not been followed, a civil court is not competent to give redress to a person on that ground in view of the decision of the Privy Council in *Venkata Rao* v. *Secretary of State for India* (64 Indian Appeals 65). The failure of the dismissing authority to observe the Rules will not furnish a cause of action for a civil suit.

As regards the necessity of previous approval of the Government, the High Court was of the opinion that, as the rules refer to previous approval only in the case of *appointment* and further

give a right of appeal to the Governor in Council from order of dismissal, an order of ***dismissal*** does not require the previous approval of the Governor in Council.

COMMISSIONER'S POSITION.

Their Lordships have further laid down that in the matter of appointment of Assistant Commissioners and Income Tax Officers the appointing authority is the Commissioner himself, and not the Governor in Council, even though by way of appeal or by way of veto or even by an executive rule as to previous approval his exercise of this power may be subject to interference by the Governor in Council. Similarly as regards dismissal their Lordships are of opinion that though there is no specific section or rule providing for dismissal, the rule which gives the right of appeal against orders of dismissal to the Governor in Council proceeds on the assumption that the dismissal is to be *by* the Commissioner of Income Tax. It may be noted here that the question whether the dismissing authority is the Commissioner or the Governor in Council is of importance in deciding whether relief can be given to a dismissed officer under Section 96-B of the Government of India Act, 1919.

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Judicial Committee on Payment Made to Employees on Retirement.

B. J. Fletcher's case [1937 I.T.R. 428, P.C.].

Companies often constitute funds for making provision for their employees on retirement. There are two provisions in the Indian Income Tax Act which expressly exempt from tax the accumulated balance remaining due to an employee in such funds, namely, Section 4 (3) (v) and Chap. IX-A. The former relates to Provident Funds falling within the Provident Funds Act of 1897 and the latter to 'recognised provident funds', that is, funds recognised by the Commissioner under Section 58-B of the Act. The recent decision of the Judicial Committee in B.J. Fletcher's case (reported below at p. 428) shows that even apart from these two provisions of law, a lump sum payment made to an employee on retirement would be exempt from income tax if the payment is really in the nature of a capital receipt.

Their Lordships point out in this case that even assuming that the sum received by an employee from a fund of this nature is a 'profit' arising from his employment, the question would still remain whether it was received by him as income or was in the nature of capital. If it represented merely the payment of accumulated portions of a salary held up by the employers until the employee's retirement, it would be received by him as deferred income and therefore be taxable and in their Lordships' view it is on this question that the decision of the case must turn. Their Lordships further say that they have no doubt that the answer must depend mainly on the constitution of the fund.

Guiding Factors.

Though, as their Lordships have clearly stated, the question whether a payment is deferred income or a capital receipt, would depend upon the constitution of the fund in each case, the factors that have led their Lordships to the conclusion that the

payment in FLETCHER'S CASE was not in the nature of accumulated salary but a capital receipt, deserve careful attention:

"The first point that emerges from an examination of the rules set out above is that the sums to be allotted were entirely in the discretion of the company. They were not bound to make any allotment in any year, and it was only if an allotment was in fact made that the officer concerned could have any claim. This of itself tends to negative the idea that the allotments were part of the officer's current salary. Nor is it suggested that it was part of the respondent's original contract of service that he should have the benefit of this fund; and unless the company chose to put him on the list he would have no interest whatever in it. Even when so listed he would have no rights until he had served continuously and satisfactorily for a period of six years. And in no case could he make any claim upon the sums allotted to him until he retired. If he died before retirement the payment of his share would be made to his legal representative, and the appellant's Counsel concedes that in that event no tax would be payable. The consideration of these factors leads their Lordships to the conclusion that the allotments made to the fund in the name of an officer of the company were not in the nature of salary for current services, but were merely the measure of a sum which the company volunteered to pay to him on the termination of his service, and that this sum, when paid, was not "*income*" and, therefore, not taxable."

A payment of this nature, is in their Lordships' opinion just as much a capital receipt in the hands of an employee as would be the payment of a lump sum from a provident fund on the employee's retirement. The latter would, apart from the specific exemption in clause (v) of Section 4 Sub-Sec. (3), be, by its nature, capital and not income, in accordance with the ruling in *Shaw Wallace's case* (59 I.A. 914).

Commissioner's Power to Dismiss Assistant Commissioners and Income Tax Officers—II.

In this issue we have reported the case of *Neelamegham Pillai* v. *Secretary of State for India* (1937 I.T.R. 424) in which the Madras High Court held that Commissioners may dismiss Assistant Commissioners and Income Tax Officers without the previous approval of the Government, though they cannot appoint them without previous approval. If this view is correct (we have

considerable doubt on the point) we think the rules should be amended so as to make previous approval necessary in the matter of dismissal also. It is obvious that *dismissal* of an officer who is in service is a much more serious matter than a new appointment, and it is only just and proper that before orders of such a serious nature are made by Commissioners, previous approval of the Government must be obtained. We would invite the attention of the Central Board of Revenue to this important matter for their careful consideration, as it affects the whole administration of income tax in India.

Reference: Right To Begin.

The Judgment of the Rangoon High Court in *Visalakshi Achi's case* (to be reported) contains some observations on the right to begin in references before the High Court. There are decisions of the Madras, Allahabad and Calcutta High Courts that the assessee should ordinarily be heard first. The Rangoon High Court has approved of this practice in this case. The CHIEF JUSTICE referring to these cases said: "I do not say that circumstances might never arise in which it might be desirable to hear the Commissioner of Income Tax first, but the Madras practice is in conformity with that of the Calcutta and Allahabad High Courts and good reason should be shown before any departure is made from it"; and Mr. Justice LEACH agreed with these remarks.

Income-tax: Compromising Claims.

The *Solicitor's Journal* (of England) contains the following interesting note on the power of income tax authorities to compromise claims relating to income tax:

"*Income Tax: Compromising Claims.*—During the hearing of a recent case in the Chancery Division, Bennett, J., questioned the legality of the Income Tax Commissioners compromising claims. It was, the learned Judge said, of importance to know who the persons were who could say to a company "you are relieved of part of your income tax." The Commissioners in that case, it was intimated, were giving up a claim against a tax, payer to the extent of £120, with the possible result that some other taxpayer might have to pay more. In response to counsel's statement that the Commissioners did compromise claims, the learned judge said that he wanted to know what authority they had to free a taxpayer from his liability. Had Parliament given them power to do so? The matter is further best alluded to

in *oratio recta* following the report in *The Times*: "Counsel: (Parliament) has given them power to collect the tax. His Lordship: Yes, but has it given them power to remit it as regards a particular individual? Parliament only has the right to say so. I don't care how many times it has been done. There is an important point of principle involved. Counsel: The practice of compromising these claims had never been challenged before. His Lordship: It is challenged now. When Paliament say that a taxpayer must pay, can anything except Parliament say he need not?" It was suggested by counsel that taxation was payable to the Crown, and the Crown must have power to remit it, but the learned judge expressed doubt on the point."—*Solicitor's Journal, 1937, p. 206.*

Commissioner's Power to Modify Question of Law which High Court Has Required Him to Refer.

Now and then we find instances where, after the High Court has directed the Commissioner to state a case, specifying also the question of law that arises in the case, the Commissioner modifies the question of law and refers in the modified form. The Oudh Chief Court has recently pointed out (see *Commissioner of Income Tax, U. P. & C. P.* v. *Behari Lall Ramachandra*, 1937 I.T.R. 417 at pp. 421-422) that if the High Court when requiring the Commissioner to make the reference has not made any modification in the form of the question as stated in the application of the assessee, the Commissioner is bound under the rules of the Oudh Chief Court to state the point of law in the form stated in the application of the assessee.

Even if there is no such express rule, it is clear that the practice of modifiying the question of law which the High Court has approved in its order under Sec. 66 (3) is to be deprecated. If the Commissioner has any objection to the form in which the question is stated in the application of the assessee, the proper stage for getting it modified is when the Commissioner appears before the High Court to show cause why he should not be required to state the case under Sec. 66 (2).

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NOTES & COMMENTS.

WHEN AGRICULTURAL INCOME ACCRUES.

(MATHIAS'S CASE: 1937 I.T.R. 435)

A person who resides at Mangalore in British India owns some coffee estates in Mysore (outside British India). The harvested coffee is brought to Mangalore. It is cured and sold in British India by the owner's selling agents, who pay over the sale proceeds to the owner at Mangalore after deducting their commission and other charges. Where does the income which the owner thus derives by the sale of coffee accrue or arise? Does it arise at Mysore where the coffee is grown and harvested or at Mangalore where it is sold and the sale proceeds are received by the owner?

Our readers are sure to give a clear answer that the income accrues in British India. The Calcutta High Court also held so in *Mohanpura Tea Co.'s* Case (1937 I.T.R. 118), but in *Diwan Bahadur Mathias's Case* (1937 I.T.R. 435) a Special Bench of the Madras High Court (Sir H.O.C. BEASLEY, C. J., VARADACHARIAR, J., and KING, J.) have dissented from the Calcutta Case and held that in such circumstances the income accrues or arises in Mysore where the agricultural produce is received in kind.

The opinion of the Madras High Court, if correct, would have far-reaching consequences. It would wholly unsettle our current notions as to what 'income' means and when income accrues. The owner of a fruit garden can be taxed as soon as he has collected the fruits, or perhaps as soon as the fruits are ripe (if agricultural income becomes taxable). A poultry farmer can be taxed on the eggs laid in his farm, whether he is able to sell them or not. The owner of a quarry can be taxed as soon as he has quarried stones and made them fit for the market.

This decision, in our opinion, ignores the true meaning of 'income'. It has not appreciated the difference between 'produce' and 'income'. In the case in question only the agricultural

produce was received in Mysore; the agricultural *income* was not received in Mysore but in British India.

Their Lordships have been influenced a great deal by the proposition laid down by the Judicial Committee that a 'receipt in kind may be taxable income'. This does not mean that whenever a man receives anything valuable in kind he receives it as income. We have to see in each case whether the receipt is a receipt of *income* or of mere *produce* or stock in trade. I may receive 20 pieces of cloth or 20 maunds of coffee in satisfaction of Rs. 100 due to me by way of interest from a debtor. Here the receipt in kind amounts to receipt of income. But merely because a manufacturer has received 20 pieces of cloth from his factory or a planter has gathered 20 maunds of coffee it cannot be held that the income in respect of those pieces of cloth or coffee, has accrued to him. We think the principle laid down by the Judicial Committee that 'receipt in kind may be taxable income' has been misapplied in this case. In referring to the 'crop of a field' as an example of income, the Privy Council certainly did not mean that as soon as a crop is harvested there is taxable income. They were only illustrating the recurring nature of income and its origin from a definite source.

It is not clear whether their Lordships confine this theory of accrual of income to agricultural income alone, but if it is so, the authority relied on, *viz.*, *Kirk's Case* is not a case of agricultural income and is no authority at all for making any difference between agricultural income and other kinds of income in the matter of accrual. Nor are we aware of any other authority for making such a distinction.

Again, how can it be said that that portion of the income which is due entirely to the business operations of the selling agents in British India has accrued in Mysore. Even assuming for argument's sake that some income accrued in Mysore, only the market price of the coffee on leaving Mysore territory *minus* the expenses incurred there could possibly have accrued in Mysore. The true view however is that the coffee brought to British India is merely the assessee's stock in trade by the sale of which he expects to make an income. There is no *income* at all until the coffee is sold or converted into money's worth.

We are strongly of opinion that, on the question where income accrues in such cases and on the interpretation of *Kirk's Case,* the decision of the Calcutta High Court in *Mohanpura Tea Co.'s Case* lays down the right view.

A Hard Case.

Under the Income-tax Act as it at present stands agricultural income from land paying land revenue in British India is exempt from tax. Similarly income from agriculture arising or accruing in a State in India from land paying revenue to that State, which is subsequently brought to British India is also exempt. But there is no provision exempting from tax income accruing or arising in British India from produce of land paying revenue to a State. This situation is created by an inadvertence of the legislature in inserting the second proviso to Sec. 4 in a wrong place. The position is somewhat anomalous. The Calcatta High Court has left the legislature to correct its errors if any. The Madras High Court has got over the hardship, but in our opinion, by propounding a theory which unsettles our fundamental notions as to what is income and when it accrues—a theory which may be used to the detriment of assessees in innumerable cases. The Income Tax Enquiry Committee have already recommended the amendment of the Act to remove the anomaly above referred to but the effect of the theory propounded in *Mathias's* case would be felt until the case is overruled.

As this question may again arise before the Calcutta High Court in assessing Bengal planters we await with great interest what the Calcutta High Court may have to say about this recent pronouncement of the Madras High Court.

Application for Reference : Commissioner's Power to Extend Time.

Under Sec. 60 (2) of the Income-tax Act an application by an assessee requiring the Commissioner to refer a case to the High Court should be made within 60 days of the date on which he is served with notice of the order complained against. The question whether the Commissioner has power to extend this period for sufficient cause was considered by the Lahore High Court recently in *Merchant Flouer Mills Co., Ltd.* v. *Commissioner of Income Tax, Punjab* (1937 I.T.R. 459) and it was held, following the opinion expressed by the Madras High Court in *Mothay Ganga Raju's* case (50 M. 335) that as the statute has not invested the Commissioner with any such power the Commissioner has no power to extend the time even for sufficient cause.

In the matter of appeals Sec. 30 (2) empowers an Assistant Commissioner to admit an appeal out of time if he is satisfied that the appellant had sufficient cause for not filing the appeal in time.

The learned Judge of the Lahore High Court has observed in this case as follows :

'I do not myself understand why a discretion should be denied to the Commissioner which is granted to the Assistant Commissioner, but there it is.'

These remarks show the necessity of extending the provisions of Sec. 5 of the Limitation Act to applications for reference in income tax cases and we would invite the attention of those who are now engaged in the revision of the Income Tax Act to this defect in the Act.

Necessity of Court Fees for Applications for Copies of Orders of Income Tax Officers.

In the above mentioned case, namely the case of *Merchant Flour Co., Ltd.* (1937 I.T.R. 459) another point of practice has also been decided. Under the Court Fees Act an application presented to any civil, criminal or revenue court or to any Board or executive officer for the purpose of obtaining a copy or a translation of any judgment, decree or order passed by such Court, Board or officer requires a court fee stamp of two annas. Does an Income Tax Officer or Assistant Commissioner fall within the classes of persons above described? An Income Tax Officer or an Assistant Commissioner is not a civil or criminal court or a Board. Is he a revenue court or an executive officer within the meaning of this provision? The Lahore High Court has held that Income Tax Officers and Assistant Commissioners are revenue courts and that an application for a copy of an order passed by them must therefore be stamped with a stamp duty of two annas.

Powers and Duties of Income Tax Officers Where Assessee's Accounts are 'Cooked' or Fictitious.

GANGARAM BALMOKAND'S CASE [1937 I.T.R. 464].

The Lahore High Court has, in *Gangaram Balmokand's Case* (reported below at pp. 464 *et seq*) elaborately discussed the procedure to be adopted by Income Tax Officers when they find that the account books produced by the assessee are 'cooked' or fictitious. As such cases are of frequent occurrence we would invite the attention of Income Tax Officers to this important case, especially in view of the fact that Mr. Justice DIN MOHAMMAD who delivered the leading judgment says that his Lordship has given

his 'most earnest consideration, in view of the importance of the question involved and the tenacity with which the Commissioner has adhered' to some untenable views. The Commissioner was of opinion that the proviso to Section 13 which empowers an Income Tax Officer to compute the income 'upon such basis and in such manner as the Income Tax Officer may determine was applicable only where no accounts were kept or the *method employed* by the assessee in keeping his accounts was not sufficient to deduce the income, that is, where there was a defect in the method itself and not where the accounts were 'cooked' or fictitious. He had further held that Income Tax Officers may impose random assessments under Sec. 23 (3) without resorting to the proviso to Sec. 13. The High Court held that "the Commissioner's view as regards the inapplicability of the proviso to Sec. 13 in such cases is not maintainable, and that he was equally wrong in suggesting that under Sec. 23 (3) unaffected by the proviso to Sec. 13 an Income Tax Officer may make any estimate that he likes, even though it is not supported by any relevant or admissible material on the record.

The points laid down by their Lordships in this case may be summarised as follows:

(*i*) the view that the proviso to Sec. 13 is not meant to be applied to rejection of accounts on the ground that they are unreliable or fictitious is erroneous;

(*ii*) the proviso to Sec. 13 can be utilised in computing the income of the assessee under Sec. 23 (3) if on weighing the evidence produced under Sec. 23 (3) or examining the accounts produced the Income Tax Officer is not convinced of their reliability and considers them as not safe guides;

(*iii*) that under the proviso to Sec. 13 the Income Tax Officer is the only proper person to decide whether the accounts are such as reflect the true income of the assessee and if he holds the contrary, he is at liberty to compute the taxable income upon such basis and in such manner as he may determine;

(*iv*) if once it is decided by him that the accounts are fictitious and unreliable his finding cannot be disturbed unless it is altogether capricious and injudicial; what has to be determined is whether he has exercised his discretion judicially;

(*v*) the law does not impose any burden on the income tax authorities to prove by positive evidence that the accounts are unreliable or that the figure at which they assess is the correct figure; on the other hand the burden is on the assessee to show that the Income Tax Officer's estimate is wrong.

Nature of Proceedings Before Income Tax Officers.

The question whether proceedings before Income Tax Officers are judicial proceedings and whether they are bound to proceed like judicial officers in taking and weighing evidence is also discussed in *Gangaram Balmokand's Case*. After an exhaustive review of the authorities bearing on the point their Lordships conclude that

"The proceedings before an Income Tax Officer are not judicial proceedings in the sense in which this term is ordinarily used and all that is required of him is to proceed without bias and give sufficient opportunity to the assessee to place his case before him, or, in other words, to conduct himself in accordance with the rules of justice, equity and good conscience."

Foreign Income: Remittance of Profits and Importing Stock in Trade Distinguished.

An interesting question regarding assessment of foreign income was recently decided by the Lahore High Court in *Spedding, Dinga Singh and Co.* v. *Commissioner of Income Tax, Punjab* (reported below at p. 490). Where a firm purchases goods in a foreign country and sells part of the stock in the foreign country and part in British India, can the stock imported into British India be held to comprise the foreign profits? In other words, can the importation of the stock to British India be construed as a remittance of the foreign profits to British India. In the case in question the assessees were lessees of some Kashmir forests. They cut trees from those forests, brought them to the Punjab and sold them there. Some of the trees were also sold in Kashmir. The profits made in Kashmir amounted to Rs. 67,000. The value of the timber brought to British India was about Rs. 8,00,000. The Commissioner held that the stock imported to British India must be presumed to comprise the available profits made in Kashmir and assessed the firm not only on the profits made by the sales effected in British India (about 3 lakhs) but also on the Rs. 67,000. The High Court held otherwise. Their Lordships were of opinion that whatever may be the presumption in the case of remittances of moneys to British India there was no presumption that the timber imported which was merely the stock-in-trade of the assessees comprised the available foreign profit. On the contrary, they said, what was received in the shape of timber was capital and the profits made in Kashmir were not therefore assessable. COLDSTREAM, J., said that the timber or its market value was not profits but only an

element in the process of production of the profits as the business of the assessee was not the acquisition of timber but the sale of it, and the profit accrued and were ascertained not by the bringing of the timber into British India, but by the selling of it.

This case is also authority for the view that mere entry of foreign profits in the accounts kept in British India and a division of the same among the partners in the books would not make such profits assessable to income tax in British India.

THE INDIA, BURMA AND (TRANSITORY PROVISIONS) TAXATION ORDER, 1937.

At the Court at Buckingham Palace, the 18th day of March, 1937.

PRESENT.

The King's Most Excellent Majesty in Council.

Whereas by section three hundred and ten of the Government of India Act, 1935 (hereafter in this Order referred to as "the India Act"), and by section one hundred and fifty-six of the Government of Burma Act, 1935 (hereafter in this Order referred to as "the Burma Act"), His Majesty in Council is empowered, for the purpose of facilitating the transition from the provisions of the Government of India Act, to make temporary provision for the purpose of removing any difficulties arising in relation to the said transition:

And whereas a draft of this Order has been laid before Parliament in accordance with the provisions of sub-sec. (1) of section three hundred and nine of the Indian Act and sub-sec. (1) of section one hundred and fifty-seven of the Burma Act, and an Address has been presented to His Majesty by both Houses of Parliament praying that an Order may be made in the terms of this Order:

Now, therefore, His Majesty, in the exercise, of the said powers and of all other powers enabling him in that behalf, is pleased, by and with the advice of His Privy Council, to order, and it is hereby ordered, as follows :—

1. This Order may be cited as the India, Burma and Aden (Transitory Provisions) Taxation Order, 1937.

2. The Interpretation Act, 1889, applies for the interpretation of this order as it applies for the interpretation of an Act of Parliament.

3. In this Order—

"Separation" means the separation of Burma and Aden from India; "the three countries" means India, Burma and Aden;

"Central taxation" means all taxes, duties, charges, fines and penalties payable or about to become payable under, or in accordance with the provisions of, the Acts specified in the Schedule to this Order;

"Outstanding central taxation" means Central taxation which had become payable before separation, or which would have become payable before separation if the existence and extent of the liability had been determined in time.

4. (1) Separation shall not affect—

(*a*) The amount payable by any person in respect of outstanding Central taxation;

(*b*) the amount to be allowed, by way of drawback, refund, rebate, or credit in assessment, to any person in respect of Central taxation, paid or treated as paid, before separation, or in respect of deposits made before separation as security for payment of Central taxation, or in respect of outstanding Central taxation paid after separation.

(2) The said amounts shall remain or become payable, or, as the case may be, be allowed, in the same places as if separation had not taken place, and the enactments relating to the assessment, demand and recovery of Central taxation shall throughout the three countries, continue to apply as nearly as may be, in relation to those amounts as if there had been no separation;

Provided that any amount paid or allowed after separation shall be paid or allowed for the benefit or at the expense of the Government of that one of those countries in which the place in which the amount first became payable or was allowed is situated, and where any amount which became payable in one of the three countries is recovered in another, any necessary adjustments shall be made between the revenues of those countries accordingly.

(3) After separation the same consequences shall flow in each of the three countries from the stamping outside that country of any document executed before separation, as would have followed therefrom if there had been no separation.

SCHEDULE.

Indian Income-tax Act, 1922.

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NOTES AND COMMENTS

Assessment of Co-owners as ' Association of Individuals '.

We would invite the careful attention of the Central Board of Revenue to the extremely confused state of the present law with regard to the assessment of co-owners. The importance of the subject cannot be over-estimated as co-ownership is a thing of very common occurrence and some of the decisions even bring within the term 'association of individuals' co-owners having separate and specific shares in immoveable property and the income thereof.

The Calcutta View.

In *In re Elias and others* (1935 I.T.R. 408 ; 63 Cal. 533) the Calcutta High Court decided, where four persons purchased a certain property in specific shares and held that property as tenants in common but executed a joint power of attorney in favour of one of them for management, that these four persons could be assessed in respect of the income accruing to them from the property as an 'association of individuals'. The learned Chief Justice said that the words 'association of individuals' have to be construed in their plain ordinary meaning. 'Associate' means 'to join in common purpose or to join in an action". These individuals joined in a common purpose, or common action and therefore became an association of individuals. If this view is correct all co-owners must be treated as an association of individuals; for co-ownership necessarily implies some joint action, and co-owners can never get on without in some respect or other joining in a common purpose or action.

The Allahabad View.

On the contrary, in *Mohammad Aslam's Case* [1936 I.T.R. 412 ; 1936 A.L.J. 1109] the Allahabad High Court held that the expression 'association of individuals' is not wide enough to cover the case of a number of persons having specified but undivided shares in property which produces income. The learned Judges who

decided this case were of the opinion that this expression is *ejusdem generis* with the word immediately preceding, *viz.*, 'firm' and that before there can be an association of individuals within the meaning of Section 3 it must first be shown that the association has at least some of the attributes of a firm or partnership, though not in the strictly legal sense of the term. They say that even the appointment by a body of co-owners, of a common collecting agent, will not convert such a body into an association of individuals, but refrain from giving an opinion as to what the position would be if the co-owners of income-producing property appoint one or more persons whether from among themselves or from outside to perform all the functions of a common scheme of management.

THE BOMBAY VIEW.

This question arose recently for decision before the Bombay High Court in *Commissioner of Income Tax* v. *Laxmidas Deridas* (Civil Ref. No. 19 of 1936). Two persons joined together in purchasing certain immoveable property, paying the price in equal shares, and jointly hold and managed the same. The High Court held that they constituted an association of individuals and could be assessed as such. The Commissioner and BLACKWELL J., have mainly relied on Sec. 9 of the Act. The Chief Justice distinctly bases his decision on the fact that the owners constituted an association of individuals. His Lordship follows *Elias' Case* and dissents from *Mohommad Aslam's Case*.

THE VIEWS CONSIDERED.

The view propounded in *Elias' Case* that whenever there is a joining for a common purpose or common action there is an association of individuals and that the income accruing to the individuals can be taxed as the income of an association—a view which is wide enough to bring the case of all co-owners of property within the term association of individuals—is in our opinion, nothwithstanding the support which it has received from the Bombay High Court, clearly unsustainable. The Allahabad decision, that the expression is not wide enough to cover the case of co-owners having specified but undivided shares in property, is as we had stated in our Notes and Comments (1936 I.T.R. p. 58) the better view. But we think the Bombay High Court is right in disagreeing with the opinion incidentally expressed by the Allahabad High Court that the expression 'association of individuals' is *ejusdem generis* with the word immediately preceding, viz., 'firm'. We had also stated, while commenting upon *Mohammad Aslams'*

Case that this reasoning of the Allahabad High Court is not sound.

In our opinion in the Calcutta and Bombay cases attention has not been directed to the most crucial point. We would reiterate here what we said in the concluding portion of our Comments at p. 59 of 1936 I.T.R.:—

"*The true test therefore, is not whether the individuals concerned have joined together for any common purpose but whether, in the plain words of Section 3 of the Income Tax Act, the income in question is in the eye of the law the income of the individuals or the income of an association of which they are the members.*" The mere fact that several persons have a common understanding or have joined together for some common purpose will not convert an income which belongs to them in specific shares into the income of an association. We may refer here to the recent case in which the Privy Council have drawn pointed attention to the necessity of paying attention to the words 'income of' in Sec. 3: (See *Kalyanji Vithaldas' Case*, 1937 I.T.R. 90).

Recommendations of the Enquiry Committee.

It is a matter for great relief that the Income Tax Enquiry Committee have disapproved the practice of assessing the income of co-owners owning specific shares in property and in the income thereof, as the income of an association of individuals. We are extremely glad to find that the committee have referred with some emphasis to the principle that 'every endeavour should be made to relate the incidence of taxation to the total income of the persons to whom the incomes actually belong'. In dealing with the particular subject of 'association of individuals' they say (p. 25): "As stated in Sec. 2 of the Chapter we consider that *to relate the ultimate rate of tax on income to the total income of the individual recipient is a principle which should be carried into effect as far as possible.* In the present state of the law this is far from being the case with income of trustees or income from investments in joint names". They then refer to *Elias' Case* and say: "One High Court has held that joint ownership of property constitutes the joint owners an association of individuals assessable as such. It will be readily seen that the tax payable on the present basis may be either more or less that the tax that would be payable if the income were assessed in the hands of the individual owners. For example, two persons own property in equal shares which yields an income of say Rs. 9,000, each of them having other income in excess of Rs. 40,000. In this case, the Rs. 9,000

will be assessed at nine pies in the rupee although the rate of tax appropriate to the individual assessees is 2 annas one pie." After thus exposing the inconsistency of this practice with the principle which according to them must be carried into effect as far as possible, they state their conclusion as follows:- "We consider that in the case of both joint ownerships and trust incomes the income, so far as it is specifically the income of an individual beneficiary, should be assessed as the income of that individual and that if the income is taxed by deduction there should be a right to small income relief. So far as income of trustees etc., is not the income of an individual beneficiary or co-owner, or so far as the individual shares are indeterminate the income should be assessable on the trustees or co-owners jointly at the standard rate of income tax and also at the appropriate rate of super tax".

It is a matter for some regret that this difference between cases where the co-owners hold specific shares and where they do not, was not even considered in the Calcutta and Bombay cases.

Thus it is obvious that on sound legal principles and a proper construction of Sec. 3 of the Act, and in view of the fundamental principle of income tax law that the rate of tax on income should be made to depend on the income of the individual recipient as far as possible, the practice of assessing the income of co-owners or beneficiaries who hold specific shares in property and in the income thereof, as the income of an association of individuals, is erroneous and undesirable and should be abrogated as early as possible.

We would advise co-owners who have been taxed as an association at a higher rate to try a refund under Sec. 48-A.

Partner Retiring Before Assessment of Firm : Right to Set off Loss in Firm.

A question of considerable practical importance, which may arise often in the assessment of business income was recently decided by the Judicial Commissioner's Court of Sind in *Gokaldas Lakmichand* v. *Commissioner of Income Tax, Bombay*, reported below at p. 519 ff.

Under Sec. 26 clause (1), if there has been a change in the constitution of a firm before making an assessment, assessment on the firm and its members should be made as if the firm had been constituted throughout the previous year as it was constituted at the time of making the assessment. Similarly, under clause (2) of the said section if at the time of making an assessment it is found that the person carrying on any business has been succeeded in such capacity by another person, the assessment shall be made on

such person succeeding as if he had been carrying on the business, and had received the whole of the profits of that year.

Where there has been a loss in the business before its transfer or reconstitution the question arises whether the original owner of the business or the retiring partner is entitled to have his loss in the business or his share of the loss, as the case may be, set off under Sec. 24 of the Indian Income Tax Act against his income falling under other heads, *e g.*, income from property.

The Sind Judicial Commissioner's Court has answered this question in the affirmative. The learned Judges hold that the original owner's or retiring partner's right to set off losses is not affected by transfer or reconstitution before assessment.

With regard to Sec. 26 which, according to the Commissioner, stood in the way of the original owner's or partner's right to set off, the learned Judges said: "It is again difficult for us to hold that these provisions apply to the assessment to be levied on Gokaldas (the retiring partner) whatever might be said with regard to their applicability to the assessment to be levied on Kishin Chand (the surviving partner). If instead of there being a loss there had been a profit in the business taken over by Kishin Chand, Kishin Chand as successor of the business might have been taxed on the footing of such profit, but this sub-section does not go further and say that if as a matter of fact there has been a loss resulting in one of the partners withdrawing from the firm, such partner is not entitled to set off his share of the loss against the profit so far as his own assessment is concerned."

The question however does not appear to be an easy one. It can be argued with some force that the provision in Sec. 26 (2) that 'the assessment shall be made on such person succeeding as if he had been carrying on business, profession or vocation throughout the previous year' precludes the income tax authorities from acting on the view that any other person had been carrying on the business in the previous year. The claim of the original owner to set off can only be allowed on the view that he had been carrying on the business during the previous year—a view which Sec. 26 expressly precludes the income tax authorities from taking. Again, suppose after incurring loss an assignment is made during the middle of the accounting year but the transferee is able to make some profit by the end of the year. Can the original owner claim to set off in respect of his share of the loss which had been incurred by the firm on the date of his retirement? The object of Sec. 26 appears to be that so far as

the transferred business is concerned the person who is the owner at the time of the assessment must be deemed to be the owner for income tax purposes during the accounting period.

Royalties Payable to Owner of Patent Rights.

Where valuable rights are transferred in consideration of the transferee paying annual sums of money to the transferor, the question arises whether the annual payments received by the latter are taxable as income, or are merely capital receipts. There have been many interesting cases on this subject in Great Britain and in India. The learned judgment of Mr. Justice TEKCHAND of the Lahore High Court in *Anantram Khemchand* v. *Commissioner of Income Tax, Punjab* [reported below at p. 511] contains a learned discussion of this subject, and illustrates the difference between receipt of a capital sum in instalments and receipts in the nature of income. In this case the owner of a patent transferred his rights to a third person in consideration of the latter agreeing to pay him Rs. 4,500 per annum as long as the patent was in force. His Lordship, referring to the law on this point, said:—

"If the transaction was an out and out sale of the patent by Khem Chand (the original owner) to the company for a definite fixed price, even though it was not payable in a lump sum but in instalments, there can be no doubt that any instalment received during the accounting period cannot be treated as taxable income, but is a capital receipt and as such exempt from assessment. If, on the other hand, it was merely a working licence granted for an annual payment it is clearly income and as such is taxable."

The statement made in this case should not, however, be understood to mean that in order that an annual payment may be income there should be a sale *for a fixed price*. An owner may part with his ownership for an annuity and even though the price is not a fixed sum, the annual payments received would be taxable. *Gopal Saran Narain Singh's Case* (1935 I.T.R. 277) *P.C.*

On the other hand, in *Catherine Spooner's Case* (1933 I.T.R. 299) where a lady sold her lands in consideration of a fixed sum of money and 10 per cent. of all the oil produced in the lands it was held that the 10 per cent. paid to her was not 'income' but in effect a payment by instalments of part of the price of the lands and as such a capital receipt.

These decisions show that no hard and fast rule can be laid down in such cases but the nature of each transaction must be carefully gone into. We would draw the attention of our readers

in this connection to the learned article on this subject which appeared in the *Law Journal* of England and which is extracted at pp. 91-94 of 1935 I.T.R. Notes and Comments.

Bad Debt: Proper Form of Question.

We would bring to the notice of Income Tax Commissioners the recent decision of the Lahore High Court in *Ditturam Idan's Case* (reported at p. 502 infra) in which their Lordships have stated the proper form in which the question of law should be framed where an assessee claims a deduction on account of a bad debt. The reported decisions show that often the question is framed in a very cumbrous manner and sometimes in such a way as to 'state the assessee out of Court'. This decision endorses and emphasises the opinion expressed by Chief Justice Sir George Rankin of the Calcutta High Court in *Binjraj Hukamchand's* case (I.L.R. 58 Cal. 1446; and now that two High Courts have laid down the proper form in which the question should be framed in such cases it is highly desirable that this form should be adopted. The form laid down is "whether the Income Tax Commissioner was upon the evidence obliged in law to allow the deduction and if not whether he has in arriving at his decision departed from or misapplied the principles which in law govern the matter." In the opinion of the Lahore High Court "the form proposed by Sir George Rankin is the only proper form in which a question of law arising out of such cases can be put".

Impartible Estates: Exemption of Sums Received By Junior Members.

The law as established by the decisions of the High Courts of India is that the allowance received by a junior member of an impartible estate for his maintenance from the holder of the estate is not exempt from income-tax. It is not agricultural income in the hands of the junior member but merely a sum paid to him by the holder who receives the agricultural income: *Saltanat Begum, In re* (1933 I.T.R. 379), *Lakshminarasayyamma's Case* (52 M. 827), *Gopal Saran Narain Singh's Case* (14 Pat. 552 P.C.; 1935 I.T.R. 237). Nor is it exempt under Section 14 (1) as 'sum received by a member of a Hindu undivided family' as an impartible estate is not an 'undivided family' within the meaning of the Income Tax Act: *Shiba Prasad Singh* v. *Prayag Kumari Bebi* (59 C. 1399), *Collector of Gorakhpur* v. *Ram Sundar mal* (56 A. 468), *Commissioner of Income Tax, Bihar and Orissa* v. *Visweshar Singh* (14 Pat. 785), *Maharaj Kumar of Vizianagaram, In re* (56 A. 1009) etc.

POSITION OF JUNIOR MEMBERS OF PUNJAB JAGHIRS.

Junior members of the Punjab Jaghirs, however seem to occupy an enviable position. Under The Punjab Descent of Jaghirs Act 1900, which has since been incorporated in the Punjab Laws Act, the Government is empowered, while recognising the devolution of the assignment of land revenue to a single person, to impose a condition that the successor so approved and accepted as such by the Government, shall make such provision out of the assignment as the Government may consider suitable for the maintenance of widows or other members of the family of the last or any previous holder of the assignment. The Lahore High Court has recently held in the case of *Kunwar Kartar Singh of Shahzadpur* v. *Commissioner of Income Tax, Punjab* (to be reported shortly) that the allowance which is received by a junior member in such a case under the orders of the Government, (though based upon an agreement between the holder of the Jaghir and the junior member) is exempt from income-tax, as it is under the statute an allowance paid 'out of the assignment', and as such agricultural income. In their Lordships' view the entire assignment is agricultural income and the agricultural nature of the original assignment is not lost by its being transmitted to junior members. It still remains a part of the assignment. The cases of *Saltanat Begum In re*, *Lakshminarasayyamma* v. *Commissioner of Income Tax, Madras*, and *Gopal Saran Narain Singh's Case* are, in their Lordships' opinion distinguishable on this point.

On the question whether the allowance is exempt under Section 14 (1), their Lordships have agreed with the view expressed in the cases relating to ordinary impartible estates that such allowances are not sums received as a member of a Hindu undivided family. But this view is of no avail to the Income Tax Authorities if the allowance is to be regarded as agricultural income.

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NOTES & COMMENTS

EFFECT OF TRANSFER OF BUSINESS ON RIGHTS TO SET OFF LOSS INCURRED BEFORE TRANSFER

GOKALDAS LAKHMICHAND'S CASE (1937 I.T.R. 579).

The decision of the Sind Judicial Commissioner's Court in *Gokaldas Lakhmichand's Case* (1937 I.T.R. 519) and our comments thereon, will be fresh in our readers' memory. In this case it was held that if the sole owner of a business transfers it, or a partner withdraws from a firm, before the time of assessment, he would, notwithstanding the provisions of Section 26 of the Indian Income-tax Act, be entitled to set off against his other income, the loss, or his share of the loss, as the case may be, which was incurred before the date of transfer or withdrawal. We had considerable doubt about the soundness of this decision and said:

"It can be argued with considerable force that the provision in Sec. 26 (2) that 'the assessment shall be made upon such person succeeding as if he had been carrying on the business, profession or vocation throughout the previous year' precludes the income-tax authorities from acting on the view that any other person had been carrying on the business during the previous year............The object of Section 26 appears to be that so far as the transferred business is concerned the person who is the owner at the time of the assessment must be deemed to be the owner for income-tax purposes during the accounting period." (*Vide* 1937 I.T.R. Notes and Comments p. 79).

THE BOMBAY HIGH COURT'S VIEW.

We now find that the Bombay High Court had so long ago as 1935 taken a view quite opposite to that of the Sind Court and it is a matter for regret that this decision was not brought to the notice of the learned Judges of the Sind Court, and had also escaped our notice. Anyhow it is a source of much gratification to us that the Bombay High Court has taken the view which in our opinion is the better one. The Judgment of the Bombay High

Court is reported in this number, vide *Bhogilal Hargovandas Patel* v. *Commissioner of Income Tax, Bombay, infra* p. 555] and it will be found therefrom that both the Chief Justice and BLACKWELL, J., are of opinion that under Sec. 26 (2) in the case of a transfer, the person entitled to any set-off in respect of losses of that year is the purchaser. The Chief Justice said that where the facts bring a case within Section 26 (2) Section 24 only applies to the assessment of the successor, and with reference to the argument that Section 26 (2) does not apply unless there are profits, his Lordship said:

"I think the effect of the section is undoubtedly to make the successor to the business liable to the assessment of the whole of the year in question in respect of the business transferred. It is true that the section does not mention losses, but clearly those will have to be brought in for the whole of the year as against the profits of the year".

His Lordship however said that it was not necessary to deal with the question whether Section 26 (2) would apply if there were no profits in respect of the business transferred and the successor had no other income and therefore no assessment was made on the successor.

BLACKWELL, J., is decidedly of the opinion that 'where a person carrying on any business has been succeeded in that business by another person, he is not entitled to claim the benefit of sub-Section (1) of Section 24 at all. With regard to the contention that unless it is shown that the successor in the business had made profits it would be open to the predecessor to claim a set-off, his Lordship said: 'Speaking for myself, I do not think that this is the true or proper construction to be placed upon Sub-sec. (2) of Section 26'. In his Lordship's opinion "it would be very strange if though the successor is to be deemed to have been carrying on the business for the whole of the year and is entitled to take into account any losses made in the business before the transfer for the purpose of the return, nevertheless the predecessor in business, another assessee, should be entitled to bring into his return the losses made prior to the transfer".

UNSETTLED STATE OF THE LAW.

Though the weight of authority is thus in favour of the view that the purchaser alone is entitled to claim a set-off even in respect of loss incurred before the transfer, the law cannot be said to be in a settled state in view of the decision of the Sind Court to the contrary and the remark of BEAUMONT, C.J., in *Bhogilal's Case*

that "it is not necessary to deal with the question whether Sec. 26 (2) would apply if there were no profits in respect of the business transferred."

Recommendation of the Enquiry Committee.

It is, of course, hard that a person should lose his right to set off loss merely by transferring the business or withdrawing from the firm. Though this particular aspect has not been noticed by the Income Tax Enquiry Committee they have pointed out the unsatisfactory state of the law enacted by Section 26 in general and have recommended that Section 26 be so amended as to provide for the assessment of the profits of the previous year on the persons who actually received those profits, with powers if necessary to recover the tax from the existing owner of the business.

This recommendation would prevent hardship to assessees without taking away the existing right of the Crown to recover the tax from the successors. But, as many separate assessments may have to be made as there have been assignments or changes in the constitution of a firm and this may perhaps lead to complications. The principle of following the business, leaving the owners to settle their accounts, has, of course, its own advantages from an administrative point of view and the question deserves the careful consideration of the legislature. Anyhow there is no harm in allowing the predecessor to set off his loss where the successor is not assessed at all even if the principle recommended by the Committee is not adopted.

'Camouflage' Companies.

The case of *Sardar Kirpal Singh & others* v. *Commissioner of Income Tax, Punjab*, reported below at p. 548 raises a question of considerable importance to businessmen, though in our opinion the real nature of the question which arose in the case was not fully realised by the parties or the counsel, or the judges who decided the case. The members of a joint Hindu family formed themselves into a limited company allotting a specific number of shares to each of them. The income tax authorities said that the formation of the company was 'a mere camouflage'. They refused to recognise the company and assessed the shareholders as a Hindu joint family. Though the High Court ultimately held that there was no material for the income tax authorities to come to the conclusion that the transaction was a mere camouflage they state the law thus:

"When a Hindu joint family constitutes itself into a company with specific shares belonging to the individual members and further introduces into the company persons who are not members of the undivided family the normal supposition would be that the transaction showed that the Hindu joint family had disrupted. It is, of course, true that this normal supposition could be rebutted by evidence showing that the whole of the transaction was a mere camouflage. . . . ."

Their Lordships have evidently applied the principle which is ordinarily applied when the members of a joint Hindu family say that they have formed themselves into a firm. In such a case it is settled law that the income tax authorities have power to enquire whether there has been a real disruption and the alleged firm is a genuine one.

Registered companies, in our opinion, stand on an entirely different footing. Once a certain number of persons sign a memorandum of association and get themselves registered as a company under the Companies Act a company conclusively comes into existence. This is one of the first principles of company law—in fact, the very foundation stone on which the entire edifice of the joint stock system rests. No one can deny the separate existence of a company. It is not open to the income tax authorities or the Court to enquire whether the company was 'a mere camouflage'. It is not open to them to overlook the existence of the company, however sinister the motives of the members might have been. The principles applicable to benami and sham partnerships have no application at all to companies. To be sound, the law as enunciated by their Lordships which we have quoted above may have to be altered to something like this;

"When a Hindu joint family constitutes itself into a company with specific shares belonging to the individual members, a company conclusively comes into existence and no amount of evidence to prove that the transaction was a camouflage will empower the income tax authorities to ignore the existence of the company and assess the members as a joint Hindu Family."

The question that arises in such cases is not one of disruption of the family within by Section 25-A of the Income Tax Act but one of succession falling within Sec. 26 (2).

Brickfields : Cost of Earth Dug up, Whether Business Expenditure.

The interesting question whether the value of earth dug up from a brickfield for the manufacture of bricks can be deducted in computing the income of a manufacturer of bricks, either as business expenditure or as depreciation of property was raised before the Allahabad High Court in the case of *Commissioner of Income Tax, U.P. and C.P.* v. *Tika Ram & Sons Ltd.* (reported at p. 544 infra). That there is an expenditure or loss cannot be denied but the question is whether the expenditure is of a capital nature. If a company purchases earth for the purpose of manufacturing bricks, it would clearly be entitled to a deduction of the price of such earth from the total income realised by the sale of the bricks during this year. But this decision shows that the case is different where the company owns the brickfield or has taken it on lease and is entitled to dig up earth from the field. 'The position in such a case, is more analogous to that of a company which is working a quarry or mine rather than to an ordinary manufacturer who purchases raw materials for the purpose of his manufacturing business. In the latter case the taxable income is the net gain or profit made by him which necessarily is the difference between the amount realised by him and the amount spent by him; whereas in the case of a lessee of a mine, quarry or brickfield, the property already exists and is taxed as realised property yielding a certain annual income to the owner or lessee'. The principle applicable to such cases is thus stated in the leading case of *Alianza Co.* v. *Bell*: "If it is merely a manufacturing business, the procuring of the raw material would not be a capital expenditure. But if it is like the working of a particular mine or bed of brick earth, and converting the stuff worked into a marketable commodity, then the money paid for the prime cost of the stuff so dealt with is as much capital as the money sunk in machinery or building."

It would thus appear that from an income tax point of view taking a brickfield on lease is disadvantageous. It is better to obtain mere permission from the owner to dig up earth and to pay him a certain amount by way of licence fee or according to the quantity of earth dug up. In a transaction of this kind it was held in *Janki Kuer* v. *Commissioner of Income Tax, Bihar & Orissa* [10 Pat. 275 ; 5 I.TC. 42], that the amounts received by the owner of the land did not represent capital and that there was no capital sale of the assets of the owner.

Maintenance Allowance Paid to Widow of Deceased Coparcener Under Decree of Court Charging Joint Property.

GENERAL RULE.

Ordinarily, maintenance allowances paid by the manager of a joint Hindu family to the widows of co-parceners cannot be deducted in computing the assessable income of the joint family. Does the fact that the widow has obtained a decree of the Court for her maintenance, charging specific family properties make any difference? Does this additional circumstance bring the case within the principle of *Raja Bejoy Singh Dudhuria's Case*? The Bombay High Court has answered this question in the negative in *Commissioner of Income Tax, Bombay* v. *Makanji Lalji* [reported at p. 539 *infra*]. The Chief Justice has held that there is no ground for the contention that the decree which fixes the amount of the maintenance alters the character of the sum which the widow receives, which is still maintenance paid to her as a widow in a joint family, although the amount is fixed by the decree.

DUDHURIA'S CASE EXPLAINED.

What then is the principle underlying *Raja Bejoy Singh Dudhuria's Case* in which the Privy Council held that allowance paid by a Raja, who had inherited an estate from his father, to his stepmother by way of maintenance in pursuance of a decree which the latter had obtained fixing her maintenance and charging the ancestral estate, should not be taken into account in assessing the Raja's income? They said it was not his income but an allocation out of the revenue before it became his income. The Bombay High Court has pointed out that the real basis of *Bejoy Singh Dudhuria's Case* and the point which distinguishes that case from cases like that of *Makanji Lalji* is that the assessee was assessed as an individual in *Bejoy Singh Dudhuria's Case* and not as a joint Hindu family. The judgment of the Judicial Committee in that case shows that the Advocate General had abandoned the contention that the assessee and his stepmother were members of a Hindu undivided family. The principle of *Bejoy Singh Dudhuria's Case* does not therefore apply to maintenance allowances where the assessee is a Hindu undivided family.

SOLE SURVIVING MEMBER.

The recent decisions of the Privy Council which have established that where a Hindu family consists of a sole surviving male member and widows of deceased coparceners, the sole surviving

member is to be assessed as an individual and not as representing a Hindu joint family, become important in this connection. Does the case of a sole surviving member fall within *Bejoy Singh Dudhuria's Case* or *Makanji Lalji's Case*? Can maintenance allowances paid by him to the other members under decrees charging the ancestral estate be deducted from his assessable income? Logic demands an answer in the affirmative, but we have to wait and see how the law developes.

Annuities Paid to Agents on Termination of Agency.

Companies often pay compensation to agents when their agency is terminated. In *Shaw Wallace and Co.'s Case* (59 Cal. 1343) the Privy Council held that a lump sum paid to an agent on termination of his agency as compensation for loss of agency was not income but capital and was not assessable to income tax. In a recent case (reported at p. 527 infra) the Judicial Commissioner's Court of Sind has distinguished *Shaw Wallace's Case* and held in somewhat similar circumstances that the moneys received by the agent are taxable. The most important fact, relied on in the Sind Case as distinguishing it from *Shaw Wallace's Case* is that the payment was not a lump sum payment as in *Shaw Wallace's Case* but an annual allowance of Rs. 500 payable so long as he lived. The learned Judges held that the 'agreement to pay a certain periodical sum of money during the lifetime of K. B. Katrak........falls clearly within the purview of Sec. 7 and is as such taxable income unless the assessee is able to bring his case within one of the exemptions contained in Sec. 4, cl. (3) of the Act. Had the employers of the assessee given a lump sum to the firm ....in consideration of services rendered by that firm a good deal might have been said in favour of the assessee." If a lump sum is fixed, even though it is paid in instalments the case, we presume, would fall within *Shaw Wallace's Case*, but where no lump sum is fixed at all but the agreement is to pay an annuity to the agent for his life, the allowance would fall within the principle of *Gopal Saran Narain Singh's Case* [1935 I.T.R. 237] as the learned judges of the Sind Court have held. Employers and agents will be well advised in noting the distinction between these two cases when drafting agreements for payment of compensation to agents.

Registration of Firms.

It was argued in a recent case before the Lahore High Court *Haji Ghulam Rasul Khuda Baksh's Case* (1937 I.T.R. 506) that the provisions of Sec. 2 (14) and Sec. 26-A of the Indian Income Tax Act coupled with rules 2 to 4 of the Rules framed under the Act left no option to the Income Tax Authorities to refuse registration if an instrument of partnership specifying the individual shares of the partners, was presented to them. It was urged that the manner in which the income tax authorities could prevent evasion of taxation was to resort to the provisions of Sec. 48 of the Income Tax Act and disallow refunds in the case of persons not proved to be genuine partners of the firm in question.

After a review of the earlier cases on the subject the High Court overruled these contentions and re-affirmed the power of the Income Tax Authorities to enquire into the reality of an alleged partnership. In the view of the High Court the instrument of partnership specifying the individual shares of the partners referred to in Sec. 26-A of the Income Tax Act means obviously a genuine instrument of partnership, and if there is evidence, direct or circumstantial showing the bogus nature of the so called instrument of partnership it is open to the Income Tax Authorities to refuse registration of the firm in question.

Their Lordships have further laid down that the burden is on the person who applies for registration to prove that a genuine instrument of partnership has been executed and that all persons named therein are actual partners and not dummies.

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NOTES ND COMMENTS.

Exemption of Agricultural Income Received in Burma Before, And Brought to India After, Separation of Burma.

As Burma became separate from India in April 1937 Income tax Officers had some doubts as to whether agricultural income received in Burma in the financial year 1936-37 and received in India in the year 1937-38 can be assessed to income tax in India. The South Indian Chamber of Commerce had drawn the attention of the Government of India to this question and to the attempts of income tax authorities to tax such income. The Government of India have informed the Chamber that agricultural income which accrued or arose or was received in Burma or British India before separation was exempt from Indian income tax and that the exemption will apply to agricultural income remitted to British India after separation if it had accrued or was received in Burma before separation. We understand that the Government of India have instructed the Commissioner of Income-tax, Madras, to exercise his revisional powers in respect of assessments made on such income.

Conversion of Foreign Income into Capital Before Remittance.

Assessees who have foreign income will read with much interest the recent decision of the Bombay High Court in *The Ahmedabad Advance Mills Ltd., In re.* A company received an income of Rs. 18,000 odd in London. They invested that income in England in the purchase of stores and machinery which they then shipped to Bombay, and the question arose whether the company were liable to pay income tax on the income received by them in London which they had thus invested in the machinery brought to India; in other words, whether the foreign income could in the circumstances be deemed to have been brought to British India. The High Court held that in order to attract income tax in India what is brought to India must be income, profits or gains and that if the assessee has converted the income received abroad into capital and then

brings that capital to India, he is not bringing into India income, profits or gains. Whether foreign income has in fact been capitalised or not is a question of fact in each case but if the Court comes to the conclusion that what is brought is a capital asset, the fact that the capital asset was acquired out of income in a foreign country is irrelevant.

It is however important to note that their Lordships say that cases can be easily imagined in which an assessee desirous of bringing into British India his foreign income for use as income in India, might convert his foreign income into some form of capital by the purchase of bonds or otherwise, bring them into India and then sell them and apply the proceeds as income. In such cases, their Lordships say, the Court would probably hold that what had been brought to the country was in fact income and not capital. It was not suggested in this case that the machinery and stores were brought to India for the purpose of being sold and the proceeds applied as income and so their Lordships held that what was brought to India was a capital asset. The case will shortly be reported in full.

Mangalore Coffee Planters' Case: Leave to appeal to the Privy Council.

Our readers may remember the case of *Diwan Bahadur S. L. Mathias* [1937 I.T.R. 435] in which a Special Bench of the Madras High Court held that where a person residing in British India grows coffee in an Indian State and cures and sells them in British India the income derived by him from the sale of the coffee accrues in the Indian States. We had stated in our Notes and Comments that this decision does not appear to lay down good law. We learn that on the 13th October the Madras High Court granted leave to the Commissioner to appeal to the Privy Council against this judgment and we await the decision of the Privy Council with great interest as the question involved is one of general importance. We may have to considerably alter our notions as to what is income and when it accrues if the ratio decidendi of the Madras High Court is approved by the Privy Council.

Provident funds of Electric Supply Companies.

Sec. 15 (1) of the Indian Income Tax Act exempts from income tax sums paid by an assessee as a contribution to a provident fund to which the Provident Funds Act 1897 (now, of 1925) applies. The Provident Funds Act of 1925 applies to Government and railway provident funds. A 'railway provident fund' is defined in Sec. 2 (ii) (g) of the said Act as 'a provident fund constituted by the authority of a rail-

way administration for any class or classes of its employees', and 'railway administration' is defined by Sec. 2 (11) (f) as meaning (i) any company administering a railway or tramway in British India either under a Special Act of Parliament or of the Indian or a local legislature, or under contract with the Secretary of State for India in Council, the Governor-General in Council or a Local Government, or, (ii) the Manager of any railway or tramway administered by the Governor-General in Council or a Local Government. An employee of an ordinary Electric Supply and Tramway Company to which a licence had been issued by a Local Government under the Indian Electricity Act 1903 and an Order had been granted under the Indian Tramways Act 1886 claimed that his contribution to the provident fund constituted by the Company was exempt from tax under Sec. 15 (1) inasmuch as the Company's provident fund was a railway provident fund within the Provident Funds Act. It was argued on his behalf that the company was administering a tramway under a Special Act as it had been granted an 'Order' under the Tramways Act and that it was also working under contract with the Local Government as it was working under a licence issued by the Local Government, and that the company was therefore a 'railway administration'. The Lahore High Court rejected both the contentions and held that the company was not 'a railway administration, its provident fund was not 'a railway provident fund' and the employee's contribution was not therefore exempt from tax under Section 15 (1). It follows that unless provident funds of such companies conform to the provisions of, and are recognised under, Chap. IX-A of the Indian Income Tax Act, employee's contributions to such funds will not be exempt.

Exemption of Officers on Deputation from British Income tax.

Indian Army Orders announce that the Board of Inland Revenue, England, has agreed that exemption may be granted from the payment of British income-tax for the period of deputation to any officer sent to the United Kingdom on deputation from India for Government puposes at the instance of the Government and also to any officer similarly placed on deputation during leave. The exemption will extend not only to his emoluments for the period, whether in the form of deputation pay or of leave pay *plus* any honorarium, but also to any remittances received in that period. Further, the period during which the officer is on deputation will not be taken into account in considering the

question of liability in respect of leave before or after the deputation.

In addition to the concessions enumerated above, the following classes of officials who came into the payment list of the Secretary of State for India are also granted exemption from the tax, namely, (1) An Indian Army officer appointed to take charge of the King's Indian Orderly Officers; and (2) An officer deputed to purchase mules and horses on behalf of the Government of India.

The exemption will continue to be granted to the Ordinance Consulting Officer, the Assistant Ordinance Consulting Officer and the Mechanical Transport Adviser who are employed at the India Office. Exemptions will not, however, be granted to military officers who are deputed to undergo course of instruction in the United Kingdom as such training forms a part of their normal military duties and while on these courses they are not fulfilling the conditions required by the concession.

Converting Agricultural Loss to Loss in Trade.

The case of the *Kauktaga Grant Ltd.*, which was decided by a Special Bench of the Rangoon High Court (Roberts, C.J., Leach, J., and Mackney, J.) affords an example of an ingenious, but, as the judgment shows, legitimate way of diverting a loss of agricultural income to loss on trade. The assessee company had let out about 28,000 acres of paddy land to tenants. Sometime before the harvest in 1931, the management of the company considered that at the then prevailing price of paddy the tenants would not be able to pay their rents. The company did not wish to reduce the rents and create a bad precedent. They, therefore, purchased the whole paddy crop at Rs. 60 per 100 baskets though the prevailing market price was only Rs. 45. In their profit and loss account they showed that the rents had been received in full and that a loss of Rs. 52,525 had been incurred in paddy trading, as they had to sell the paddy bought from the tenants at a lower price. The Income Tax Officer thinking that a loss of agricultural rent had been shown as a loss in trade, recast the paddy trading account on the basis of a purchase price of Rs. 45 and in this way arrived at a profit. The High Court held that the income-tax officer was not entitled to do so but was bound to accept the price actually paid by the company and to calculate the profit and loss on the basis of the said purchase of Rs. 60.

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NOTES AND COMMENTS.

Depreciation of Machinery Remaining Idle under Pooling Agreement.

The Bombay High Court has decided in *Viswanath Bhaskar Sathe* v. *Commissioner of Income Tax, Bombay* (reported below at p. 621) a question which is of vital importance to owners of factories who enter into pooling agreements. Very often under such agreements the factories are worked in rotation and some of them therefore remain idle though the owners thereof receive a share in the profits out of the pool, and the question arises whether the owner of factories which are not worked are entitled to claim depreciation allowance in respect of the plant and machinery of their factories The question is, as the learned Chief Justice of the Bombay High Court said 'easier to state than to answer.' Under Sec. 10 (2) (vi) of the Indian Income Tax Act depreciation allowance can be claimed only in respect of plant and machinery 'used for the purposes of the business,' and the point to be answered is, can the plant and machinery of those factories which are not worked be said to be used for the purposes of the business, the income from which is being taxed.

BHIKAJI VENKATESH'S CASE

The Judicial Commissioner's Court of Nagpur (as it then was) decided in *Bhikhaji Venkatesh's Case* (p. 626 infra) that the words 'used for the purposes of the business' in Sec. (2) mean 'actually used' and not 'generally used' or 'capable of being used' and that therefore owners of factories which remain idle under pooling arrangements are not entitled to claim depreciation allowance in respect of the buildings, plant and machinery attched to their factories.

VISWANATH BHASKER SATHE'S CASE.
(1937 I.T.R. 621).

The Commissioner of Income Tax, Bombay, relying upon *Bhikhaji's Case* refused to allow depreciation under similar circum-

stances in *Viswanath Bhaskar Sathe's Case*, but on a reference under Section 66 (2) the Bombay High Court has drawn an important distinction which owners of factories who wish to avail themselves of depreciation allowance should carefully note. The pooling agreement in *Sathe's Case* contained a clause to the following effect:—

"In order to entitle the parties hereto to keep their respective shares in the said pool as mentioned in clause 7 hereof, they shall keep and maintain at Dhulia during the continuance of this agreement his or their gins or other working plant with the machinery appertaining thereto as they exist at the date of this agreement and shall at all times at their own expenses keep the same in good repair and condition and in working order and shall not during the said term remove or permit to be removed any such gins or machinery at Dhulia to any other place or places."

The learned Judges of the High Court said that this clause imposed on the assessee the obligation during the year of assessment at his own expense to keep his gins and other working plant and machinery in good repair and condition and working order and that it was on account of this obligation that he became entitled to a share of the profits made by the pool. Their Lordships agreed with the Commissioner's view that 'used' denotes actual user and not merely being capable of being used, but held that where machinery is kept ready for use at any moment in a particular factory under an express condition from which taxable profits are earned the machinery must be said to be used for the purpose of the business which earns the profits. The word 'used' in Sec. 10 (2) is used in a wider sense than 'actual working.' It embraces passive as well as active user. *Bhikaji's case* is distinguished on the ground that it does not appear from the report of that case that there was any covenant to maintain the machinery in question in reserve ready for actual use during the year of assessment.

THE RATIO DECIDENDI.

The Bombay High Court's decision is certainly right but, in our opinion, the principle underlying the decision is not confined to cases where there are express covenants to keep the machinery ready for use at any moment, but a little wider. The true principle is that contained in the statement of their Lordships that 'used' does not mean 'actually worked' and that it embraces active as well as passive user. 'User' is different from 'actual working.' Machinery may be actually *used* for a business though it is not

actually *worked* and if it is ***actually used*** for the purposes of a business, even though not worked depreciation allowance must be given, whether the user is in pursuance of an express covenant with a third party *or otherwise*. Covenant with a third party to keep machinery ready for use at any time is only a piece of evidence showing that in fact the machinery has actually been *used* for the business and also a reason for actual user.

The real question that falls for determination therefore when a claim for depreciation is made in respect of machinery remaining idle is whether the machinery was *used* for the purpose of the business though it was not actually *worked* and once the difference between *user* for the purpose of a business and *actual working in the course of that user* is clearly realised most of the difficulty will disappear. In our view it is entirely erroneous to say that unless a machine is actually worked it cannot be said to be used for the purposes of the business. A printer may have equipped his press with different kinds of machines for different classes of work. Suppose for one year he does not get work suitable for a particular kind of machine, can it be said that the machine was not used for the purposes of his business? A machine may be kept always ready in reserve to provide for the contingency of breakage of other machines. Again, for some months one machine may be worked and for some months another, or a machine may have work only for a few days in the year. The machinery in such cases is used for the purposes of the business throughout the year though worked only for a few days or not at all. 'Use' as the dictionary shows means 'employ for a particular purpose'. When machinery is solely devoted and set apart for being worked in a business and kept ready for work at any moment, whenever work comes, it is used for the purposes of the business whether work comes or not. The analogy of the meaning of the word 'practice' is very illuminating in this connection. A lawyer or a doctor must be said to 'practise' so long as he takes up that profession and keeps himself ready to accept work even though he does not get any work. In this view *Sathe's Case* is only an instance of machinery being used for the purpose of a business without being actually worked—an application of the principle that there may be actual 'user' without actual 'working.' Anyhow as authorities now stand, especially since the Bombay High Court has not dissented from, but only distinguished *Bhikaji's Case* assessees can claim depreciation allowance in such cases only where there is an express covenant in the agreement to keep the machinery ready for use at any moment

and we would draw the careful attention of factory owners and persons who draft pooling agreements to this (as the law stands at present) important covenant.

Some Important Pronouncements on Assessment Proceedings.

The Allahabad High Court has in a recent case *Rajmani Devi* v. *Commissioner of Income Tax, U.P.* (1937 I T.R. 631) made some pronouncements on income tax enquiries and the legality of notices under Sec. 23 (2) of the Indian Income Tax Act, which deserve the careful consideration of the income tax department. The opinion of the Allahabad High Court, if it is correct, would considerably curtail the powers of income tax officers as they are at present understood.

Sec. 23 (2) of the Income Tax Act prescribes that if the Income Tax Officer has reason to believe that a return made under Sec. 22 is incorrect or incomplete he shall serve on the person who made the return a notice requiring him, on a date to be therein specified, either to attend at the Income Tax Officer's office or to produce or cause to be produced any evidence on which such person may rely in support of the return. The Allahabad High Court has held in the abovementioned case that under this clause the choice is with the assessee and not with the Income Tax Officer to decide whether the assessee should attend at the office or produce or cause to be produced any evidence upon which he may rely and that if the notice does not give the assessee this choice it is illegal.

In *Rajmani's Case* the words "or produce or cause to be produced any evidence...." were scored out from the notice, that is, the assessee was required to attend the Income Tax Officer's office. The High Court held that the notice was illegal as the assessee was thus denied a valuable right, and the subsequent proceedings which terminated in a best judgment assessment under Sec. 23 (4) were therefore illegal.

Their Lordships say: '........although the Income Tax Officer may be of the opinion that the explanations furnished by the assessee might remove the Officer's suspicion, yet the assessee might feel that no amount of explanations furnished by him would remove the doubts of the Officer, and it would be necessary for him to produce some evidence in support of the return, *and if the notice directed only the attendance of the assessee, the latter would not be able to produce valuable evidence.*" And again, "It seems to us that if the Income Tax Officer were the final Judge in the mat-

ter it would work great hardship on the assessee and *the assessee in those cases in which the Income Tax Officer requires only the attendance of the assessee might lose the valuable right of producing the evidence in support of the return and removing the doubts of the Officer."*

Is This View Sound?

With all respect to the learned judges, we doubt the soundness of this view. First, assuming for argument's sake that the option is with the assessee to decide whether he should attend the office or produce his evidence, does the fact that the assessee was called upon by a notice under Sec. 23 (2) to attend the Income Tax Officer's office deprive him of his right to produce such evidence as he desires to adduce, in support of his return? Sec. 23 (3) clearly provides that on the day specified in the notice under Sec. 23 (2) of the Income tax Officer *after hearing such evidence as such person may produce........*assess the total income.' This clause confers a right on the assessee to produce his evidence and imposes a duty on the Income tax Officer to hear any evidence that the assessee may produce. Even if the Income tax Officer has in his notice under Sec. 23 (2) only required the assessee to attend his office, the assessee is entitled under Sec. 23 (3) to adduce such evidence as he wants to adduce. The fact that the words " or to produce or cause to be produced such evidence etc. " are scored out from a notice under Sec. 23 (2) will not therefore deprive the assessee of his right to adduce his evidence or any other valuable right, nor is it intended to have that effect. It only means that the Income Tax Officer at that stage only requires the attendance of the assessee and does not wish to call upon the assessee to produce all his evidence also. The position would, of course, be altogether different if the Income Tax Officer refuses to hear the evidence produced and thus disregards the duty imposed on him by Sec. 23 (3).

Again, the view that it is for the assessee to decide whether he should attend the Income Tax Officer's office or produce his evidence is also in our opinion untenable. The notice refers to cases where an Income Tax Officer has reason to believe that a return is incorrect or incomplete. He has to come to a definite finding on the correctness or completeness of the accounts and assess the total income. It must naturally be for him in the first instance to decide how he can solve his doubts and arrive at the true income—whether the assessee should be required to attend

his office or to produce his accounts. Further, he must certainly have power to enforce the attendance of the assessee and question him. There is no justification for conferring upon the assessee a right to keep himself away from the office of the Income Tax Officer and every justification for conferring upon the officer a power to require the assessee to attend his office. The choice as to whether in the notice under Sec. 23 (2) the assessee should be required to attend in person or to produce his evidence must in the very nature of things be with the officer and not the assessee. The assessee's rights are amply safeguarded by the next clause [Sec. 23 (3)] which imposes a duty on the Income Tax Officer to hear such evidence as the assessee may produce.

The notice under Sec. 23 (2) has to be issued in several hundreds of thousands of cases every year and we hope the income tax department will, when the next occasion arises, move the Allahabad High Court to reconsider this decision and to refer the matter to a Full Bench if necessary. This opinion of the Allahabad High Court is, of course, not binding on the other High Courts or the Income Tax Officers of the other provinces.

In our opinion the true view is that (i) a notice under Sec. 23 (2) in which the words 'or produce or cause to be produced any evidence on which such person may rely in support of his return' are scored out is not irregular or illegal; (ii) it does not deprive the assessee of the right conferred by Sec. 23 (3) to adduce at the hearing such evidence as he wants to adduce, or preclude the Income tax Officer from calling upon the assessee to produce his evidence later on; (iii) even if such a notice is deemed irregular or defective the irregularity is cured if the Income-tax Officer hears such evidence as the assessee wants to produce; (iv) Sec. 23 (2) does not confer a right or impose a duty on the Income-tax Officer or the assessee to make an irrevocable choice as to whether the assessee should attend or produce his evidence. The use of the word 'choice' itself is inappropriate and misleading in this connection.

Reference to High Court in Best Judgment Assessment Cases.

Though on the point mentioned above, we think that the opinion of the Allahabad High Court requires re-consideration, *Rajmani Devi's Case* contains clear and lucid statement of the law relating to the competency of references to the High Court in cases of best judgment assessment. Their Lordships have rightly pointed out the necessity of distinguishing between references from orders of best judgment assessment and appeals

preferred therefrom, and references from orders under Section 27 refusing to cancel a best judgment assessment and appeals from such orders. They have rightly laid down that in the latter case the view that the question whether the assessee was prevented by sufficient cause is always a question of fact is erroneous. As their Lordships say, though in the majority of cases no question of law would ordinarily arise out of the decision of an Assistant Commissioner dismissing an appeal from an order under Sec. 27 refusing to cancel a best judgment assessment, it cannot be said that no question of law can ever arise in such a matter. The illegality of a notice, non-compliance with which has brought about a best judgment assessment, can be agitated under the expression prevented by sufficient cause, and the question whether a notice was illegal and the assessee had therefore sufficient cause being a question of law, can be referred to the High Court.

False Return : Power of Income Tax Officer to File Complaint.

The question whether when a false return of income is made the Income Tax Officer to whom it is made can make a complaint for the prosecution of the assessee without the sanction of the Assistant Commissioner was raised in a very recent case before the Nagpur High Court, *Hazarilal* v. *Emperor*, reported at p. 610 infra. Section 52 of the Income Tax Act provides that if a person makes a statement in a verification mentioned in Section 22 (and certain other sections) which is false he shall be deemed to have committed an offence under Sec. 177 of the Indian Penal Code and Sec. 53 lays down that a person shall not be prosecuted for an offence under Sec. 52 except at the instance of the Assistant Commissioner. If the offence was really one under Sec. 52 it is thus clear that the Income Tax Officer has no authority to make a complaint without the sanction of the Assistant Commissioner. There is however a general provision in Sec. 476 of the Criminal Procedure Code under which a 'Court' can direct prosecution of certain offences committed before it. If Income Tax Officers are 'Courts', then they would have power under Sec. 476 to direct a prosecution in the case of a false return. The Nagpur High Court has held in *Hazarilal's Case* that Income Tax Officers are 'Courts' and that they can therefore make a complaint without reference to the Assistant Commissioner and this view seems to be supported by *Mr. Sundaram* in his *Law of Income Tax*. We however entertain some doubt as to whether the general provision contained in Sec. 476 of the Criminal Procedure Code can override the

specific provisions contained in Secs. 52 and 53 of the Income Tax Act. Anyhow we find it difficult to follow the view of the Nagpur High Court that 'Sec 52 of the Income Tax Act deals only with a false statement in the verification clause and does not cover a false statement of income to which the verification clause is attached.'

Income Tax and Statesmanship.

A Law Journal of England contains an interesting note under the above caption:—

In the paper of "Income Tax" which he read at the meeting of the Law Society, Mr. Randle Holme dealt with a familiar and painful subject. Sixty years ago it had not settled down into the atmosphere of inspissated gloom which now surrounds it. It is a tax on thrift. It punishes the industrious apprentice and lets his idle brother go free. With respect, we agree, but then there are so many things which are the negation of statesmanship. However, Mr. Holme, reminded his hearers that some 60 years ago—when, we presume, there really were statesmen—there was a unanimity of opinion that income tax ought to go. In 1874—the date and the history we take from Mr. Holme—Mr. Gladstone promised, if he was returned to power, to diminish local taxation and repeal the income tax. Mr. Disraeli said, in effect, it was the very thing he had always wanted to do. "The Muse of History may wonder why, if both political parties were agreed, the income tax was not at once repealed." And the Muse of History is left wondering, for, as Mr. Holme correctly says, the income tax is still with us. And at 7*d.* in the *l.* it would have been so easy to get rid of it. A chance was lost which is never likely to return. It was one of the catastrophies of the Great War that statesmen—of course, not really statesmen—found out how frutiful a source of revenue income tax can be; and how easily increased. Only this year the then Chancellor of the Exchequer and present Prime Minister put on another 3*d.* with the disarming plea that it made a prettier rate to work with.

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Special Adviser to the Government of India.

The news that Mr. S. P. CHAMBERS has been appointed as Special Adviser for Income Tax to the Government of India has been confirmed by a statement made in the House of Commons in reply to a question concerning the appointment. The statement runs as follows: "The Government of India is satisfied that there is no officer immediately available in India possessing the qualifications considered necessary for the appointment. This post requires special technical qualifications and I am convinced that the Government of India has made the best choice." Judging from the nature of the work done by Mr. S. P. CHAMBERS in connection with the Income Tax Enquiry Committee we cannot but entirely agree with the remark that the Government of India have made the best choice. In our review of the Report of the Committee we said: "Though we thought at first that several criticisms may have to be made, a careful study of the Report has only evoked sincere admiration for the very careful, precise, practical and impartial recommendations of the Committee. The public of India must ever be grateful to the learned members of the Committee for the services rendered by them." (*Vide* Income Tax Reports 1937, March issue). We have had since that date to refer to the Report on innumerable occasions and our opinion has only been strongly confirmed. We welcome the appointment of one who has taken such a prominent part in drawing up this Report which marks a new era in the administration of income tax law in India.

Assessment of Insurance Companies: 'Last Preceding Valuation.'

A novel but important question relating to the assessment of insurance companies was decided by the Madras High Court on the 22nd of October in the matter of the assessment of the *Andhra Insurance Co. Ltd.*, for the assessment year 1934-35. Rule 25 of the Rules framed under the Indian Income Tax Act provides that in the case of life assurance companies incorporated in British India whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the life assurance business shall be the average annual net profits disclosed *by the last preceding valuation*. What is the exact meaning of the expression 'last preceeding valuation'? Does it mean the valu-

ation which was last made before the assessment in question, or the valuation for the last valuation period which expired before the assessment. The question becomes important when a new valuation period expires before assessment but the valuation is not actually made until after assessment.

THE DECISION.

The first actuarial valuation of the Andhra Insurance Co., was made in December 1930 in respect of the period of 4 years which ended on 31-12-1929 and in accordance with Rule 25 the Company was assessed for the years 1930-31, 1931-32, 1932-33 and 1933-34 on the annual average profits disclosd by this valuation, namely, Rs. 8,294. The second actuarial valuation for the 4 years ending on 31-12-1933 was made in December 1934 and the average annual net profit disclosed by the valuation was Rs. 39,755: but, as this valuation was not ready at the time when assessment was made for the year 1934-35, the Company was assessed on the basis of the old valuation. As the second valuation showed larger average annual profits, the Income tax officer took proceedings under Section 34 and assessed the difference between the old and new average profits as income which had escaped assessment.

The Commissioner of Income tax held that the last preceding valuation on the basis of which assessment for 1934-35 had to be made was necessarily the valuation covering the years 1930 to 1933 and the assessment could not be made on the basis of the valuation for the still earlier period merely because the valuation for 1930-33 was not ready when the assessment happened to be made. The Company relied on a literal construction of the words 'last preceding valuation' and argued that the last preceding valuation in this case was the valuation for the period 1926-29. The High Court decided the case in favour of the Company.

NECESSITY OF AMENDING RULE 25.

Insurance companies thus stand to gain, and the Government to lose, if valuation is postponed. Equity is in favour of the Commissioner's view though on the wording of Rule 25 as it stands the decision of the High Court cannot be assailed. This seems to be a matter which the income tax department should bring to the notice of the legislature or rule making authority. A special provision may be made in Rule 25 to provide for cases where a new actuarial valuation period expires before assessment but valuation is not made. In such cases though assessment is made on the basis of the old valuation, power should be given to the department to make a supplementary assessment if the

average annual profits disclosed by the new valuation are higher.

Business Expenditure: Sums Spent by Newspaper Company to Defend Editor Against Criminal Proceedings.

In the *Amrita Bazar Patrika Case* reported at p. 648 infra the interesting question whether a newspaper company is entitled to claim as business expenditure amounts spent by it for defending its Editor and Publisher against proceedings for contempt of Court was considered by the Calcutta High Court, and COSTELLO and PANCKRIDGE, JJ., who heard the case answered the question in the negative without any hesitation. It was contended on behalf of the company that a newspaper has to publish news from all quarters, that there is always some risk in conducting the business and the risk attendant to the business of publishing must be borne by the business itself. Their Lordships, however, said that the question was whether the expenditure was incurred solely for earning profits or gains. The proceedings in contempt were against the Editor and the Publisher. The expenditure was primarily incurred by them and there was no obligation on the company to reimburse them. It cannot therefore, in their Lordships' opinion, by any process of reasoning the regarded as expenditure incurred to earn profits. Their Lordships however say that they were not concerned with the question whether the expense incurred could be treated as a business loss. This aspect of the question may have to be considered when a similar case arises.

In this case there was no obligation, except perhaps a moral one, to reimburse the Editor and the Publisher. But in a case where one of the conditions of service, express or implied, is that the employer should indemnify them against all losses incurred in such proceedings, this argument would not apply and the expenditure would in fact be one incurred for earning profits as much as the Editor's pay. The question would however still remain whether the obligation is an illegal or immoral one in the eye of the law.

Relief in Respect of Dominion Tax on Interest Paid to Debenture Holders.

The decision of the House of Lords in *Assam Railways and Trading Co.'s Case* (1935 A.C. 445; 1934 I.T R. 467) in which the principles relating to relief in respect of Dominion income tax under the English Finance Act were laid down by the House, was recently analysed and explained in detail by the Court of

Appeal in *National Mortgage and Agency Co. of New Zealand* v. *Inland Revenue Commissioners* (LORD WRIGHT, ROMER, L. J., and GREENE, L. J.)

The Court of appeal have made some further pronouncements in the *New Zealand Co.'s case*, which companies doing business in the Dominions and the United Kingdom would read with interest. In this case debenture interest was permitted to be deducted by the New Zealand Act as a business expenditure, but the company was assessable and was in fact assessed in respect of what it paid for this interest under a different provision of the New Zealand statute under which a company is to be the agent of the debenture holders for the purposes of the Act and is assessable in respect of interest paid to them accordingly. It was held that under these circumstances the company was entitled to relief in respect of the tax paid on debenture interest. ROMER, L. J., said: "It is true that as regards such last mentioned part of the company's profits the company has only been assessed as agents for the debenture holders; but this is immaterial. In order to get relief under the section it is sufficient for the company to show that it has paid the New Zealand tax on that part of its profits. The question in what capacity it has paid it and the question whether the tax falls ultimately on the company or the debenture holders are beside the point."

SUCCESSION TO BUSINESS.

MANSOOKHLAL ZAVERI'S CASE [1937 I. T. R. 664].

The question whether a person carrying on a business has been 'succeeded in such capacity' by another person within the meaning of Sec. 26 (2) of the Indian Income Tax Act is one of the most difficult problems that income tax authorities have to solve. The recent cases of *Gregory & Co. In re* [1937 I.T.R. 13] in which three Judges of the Calcutta High Court took three different views and *Kannappa Naicker & Co.* [1937 I.T.R. 49] show the extremely complicated nature of the questions that arise in such cases. A special Bench of seven Judges of the Rangoon High Court (ROBERTS, C. J., SEN, MOSLEY, LEACH, DUNKLEY, MACKNEY and BRAUND, JJ.) have recently laid down some propositions relating to succession in *Mansookhlal Zaveri's Case* [1937 I.T.R. 664] to which we would draw the careful attention of our readers.

The opinions expressed by their Lordships in this case are in our view very sound and can safely be taken as our best guides. This case is also of great weight as an authority as seven learned

Judges have taken part in decision and all of them have practically concurred.

QUESTION OF SUCCESSION IS NOT A PURE QUESTION OF FACT.

With regard to the nature of the question that arises in such cases their Lordships have rightly laid down that it is not correct to say that in every case the question whether there has been a succession is a pure question of fact. In order to answer the question it is necessary to ascertain the facts: but once the facts are ascertained, the question whether on the facts so ascertained the assessee has 'succeeded another in such capacity' within the meaning of Sec. 26 (2) is a question of law and it is always open to an assessee who desires to argue the legal consequences of the facts to require a reference as to whether the Commissioner has attributed in law the correct legal consequence of the facts he has found.

PROPER MODE OF FRAMING THE QUESTION.

The learned Judges then point out the distinction between cases where the question is whether the legal quantum of evidence necessary to support a finding of succession exists and cases where the question is whether on the facts stated, the conclusion that there has been a succession is correct. The proper mode of framing the question in the former case is whether there were materials on which the Income-tax Officer could come to the finding he had arrived at and in the latter case, whether on the facts stated his finding was correct in law.

SUCCESSION TO PART OF A BUSINESS.

On the question whether there can be succession to part of a business the leading observation is that of PAGE, C. J., in the case of *N. N. Firm* (I.L.R. 11 Rang. 501; 1934 I.T.R. 34). The learned Chief Justice there said: "where a business is split up and thereafter another person carries on part of the business, I am of opinion that he does not 'succeed' his predecessor in carrying on the business within Sec. 26 (2) of the Act." On this question COSTELLO, J. referring to the above observation, said in *Gregory's Case* (1937 I.T.R. 12) "I have no doubt whatever that it is right to say that there cannot generally speaking be a succession to a part of the business; but that, in my opinion, does not imply that if what is succeeded to is not the same extent of trade or even does not include a particular line or set of customers it necessarily follows that there cannot be a succession to the trade or business." The mere fact that the operations carried on by the transferee are not so extensive as the operation which had been previously carried on does not, his Lordship said, necessarily lead to a conclusion that there was not a succession. In *Zaveri's*

Case also the learned Judges have explained PAGE, C.J.'s observations. ROBERTS, C.J., referring to this observation, said: This is only another way of saying that where a person has carried on a business no one can be said to succeed him in such capacity when only part of the business is taken over" but MOSELY, J., openly says: "A regards what was said in *N. N. Firm's case*, that a person who carries on a part of a business only does not succeed his predecessor in carrying on the business within Section 26 (2), this is perhaps stated too broadly. It has I think rightly been held that succession to a separate branch of a business constitutes succession within the meaning of the rule, and the Indian rule is for this purpose identical with the English." The learned Judges thus practically agree that PAGE, C. J.'s observations are a little broad. The practical application of the principles stated in these judgments to concrete cases is still a difficult ask for income-tax authorities.

CONTINUITY OF BUSINESS.

In *N. N. Firm's case*, PAGE, C. J., further said: "Where there is no continuity in carrying on the business and when one business has come to an end and another business is started, it may be with the same assets and under the same conditions and in the same premises as the old business, the persons carrying on the new business do not succeed those who had carried on the old business within Sec. 26 (2) of the Act." *Zaveri's case* shows that this statement of the law also has to be read with some caution; for the learned Judges, referring to the above passage, say that this sentence should not be interpreted as a proposition of law of necessarily universal application. They point out that in *Madam Tussaud's case* (17 Tax Cas. 127) though a long interval of about 3 years had elapsed before the purchaser resumed the business carried on by his vendor it was held there was a succession. Their Lordships lay down the correct test in an excellent passage which runs as follows:—

"The question really comes down in all such cases to this: whether there is a delay which as a matter of law the Commissioner is bound to regard as forcing him to infer that there was not a succession. This delay is a question of degree and in some cases the delay may only mean a cesser of profit making operations and never any real cessation of the business at all. The real test is the identity of the two businesses, and when this comes to be considered the reasons for any delay between closing down and opening up again may throw a light upon the correct solution."

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Succession : Transfer of Sole Agency Business.

The case of *Tolaram Ramdas & Co*. (reported below at p. 680) decides a question of much importance to traders and business-men. A company, along with other businesses, carried on the business of sole agents and distributors of Pfaff sewing machines in a particular locality. They transferred their entire stock-in-trade consisting of sewing machines and spare parts, their rights under hire purchase agreements relating to machines supplied by them, and their rights as sole agents and distributors of Pfaff & Co. to another company, and the question for decision was whether the latter could be treated as having 'succeeded' the transferor company in business and could be assessed to income tax under Section 26 (2) as successors in business on the entire profits of the previous year.

The Judicial Commissioner's Court of Sind held that the assessees were not successors in business to the transferor company. The learned Judges are of opinion that the transfer in such cases is merely a relinquishment of his agency by the transferor and the grant of a similar right by the manufacturer to the transferee; the goodwill if any is that of the manufacturer and not of the sole agent; there is no continuity of venture; and there is therefore no succession to any business. They are of opinion that where the subject matter of transfer is the right to represent the manufacturer of a particular article in a specified area and the transfer is of no effect without the consent of the manufacturer, there can be no succession within Section 26 (2). We fail to see why if the agent has a transferable right, a transfer of the same should not be viewed as a transfer merely because consent of a third party is necessary. The case is, of course, different if the right is not transferable by law or by agreement between parties. The position that in the case of sole agency for sale and distribution of a manufacturer's articles, the agent has no goodwill is also somewhat

doubtful. We are awaiting the opinion of the other High Courts on this important question.

Leave to Appeal to Privy Council: High Court's Power to Make Order Relating to Costs.

We often come across cases where, though the amount of tax involved is small, an important point of law affecting the Crown is involved. The Crown may find it necessary in such cases to appeal to the Privy Council and if the appeal is successful the assessee may find himself mulcted in costs far exceeding the amount in dispute. The Madras High Court has held that the High Court has no power of granting leave to appeal in such cases to impose a condition that the Commissioner should bear all the costs of the appeal. The Privy Council alone has power to decide the question of costs in such cases. *Commissioner of Income Tax, Madras* v. S. L. *Mathias* (to be reported shortly).

Mutual Benefit Societies With Nominal Membership For Borrowers.

The *Trichinopoly Tennore Hindu Permanent Fund's Case* (reported at p. 703 below) is an instance of a case where a company carrying on banking business unsuccessfully claimed the status of a mutual benefit society and the resulting exemption from tax, by creating a nominal membership for borrowers. A special class of shares of Re. 1 withdrawable after two years was created. Every borrower had to take a share. The profits were however distributed to the real shareholders. Out of a gross income of Rs. 14,217 earned by the Company by way of interest on loans in the year in question only Rs. 139 went to these borrowers by way of dividend. The High Court held that it was impossible in the circumstances to hold that the company was a mutual benefit society. They said that the constitution of the company was different from that of the Company which was exempted in the *Mylapore Fund Case* (47 M. 1) and the principle of the Mylapore Case was not applicable to the case of companies advancing loans to such nominal borrowing members.

Res-Judicata in Income tax Proceedings.

The question whether a decision once made by an Income-tax Officer binds him or his successors in the assessment for succeeding years is also answered in the *Trichinopoly Tennore Hindu Permanent Fund Case* (1937 I.T.R. 703). The contention that the assessee was a mutual benefit society was accepted in 1928 and its income was not accordingly assessed to income-tax for the years

1928-29, 1929-30, 1930-31. In 1931 on a more careful consideration the income tax authorities came to the conclusion that it was not a mutual benefit society. Their Lordships held that the fact that the company was not assessed for some years could not prevent the authorities from levying tax from 1931 onwards. They said that Income-tax Officer does not constitute a Court, and therefore the doctrine of *res judicata* can have no application, though assessments once made are final unless they can be reopened under some provision of the Act.

Deduction of Tax on Salary : Employer's Duties : Amendment of Rules.

Sec. 18 of the Income-tax Act imposes a duty on persons responsible for paying any income chargeable under the head' salaries' to deduct at the time of payment income tax on the amount payable; and Rule 11 of the Income Tax Rules provides that, where deduction is not made by or on behalf of the Government, *the person paying the salary shall send to the Income-tax Officer concerned* or to such officer as he may direct and shall send therewith a statement showing the name of the employee from whose salary the tax has been deducted, the period for which the salary has been paid, the gross amount of the salary, the amount of tax deducted, etc. This Rule has recently been altered by a Notification dated 6th Nov. 1937 (published in the Gazette of India of Nov. 13, 1937) which provides that for the words underlined above, the words '*the person making the deduction shall send to the Income-tax Officer within whose jurisdiction the deduction is made* shall be substituted, and adds a proviso to the rule to the following effect: ' Provided further that in respect of employees who are employed in places outside that officer's jurisdiction there shall be submitted along with the statement a separate extract thereof for each other place in which an employee works. Under the new rule therefore, (i) the liability is not on the person paying the salary but on the person deducting the tax, (ii) the tax is to be sent to the officer within whose jurisdiction the deduction is made and (iii) if the employee works outside that jurisdiction a separate extract for each such other place where he works has to be annexed to the statement of particulars sent.

Assessment of Insurance Companies : Some Anomalous Situations.

DELAY IN ACTUARIAL VALUATION.

The case of the *Andhra Insurance Co., Ltd.* to which we had referred in our last issue is reported at p. 697 below. We have already dwelt upon the necessity of amending Rule 25 of the Income tax Rules by adding a proviso or explanation therein to empower the income tax authorities to make a supplementary assessment where a new period of actuarial valuation expires before return but the valuation is not made before the return is due. Otherwise there will always be a temptation for insurance companies to delay actuarial valuation as far as possible.

ASSESSMENT BEFORE FIRST ACTUARIAL VALUATION.

In *Andhra Insurance Co.'s case* their Lordships have referred to *Lakshmi Insurance Co.'s case* (I L.R. 12 Lah. 757), another case which reveals a much worse situation. This case lays down that until the first actuarial valuation is made insurance companies cannot be taxed at all; and as such companies are bound by law to have an actuarial valuation only within 5 years, for the first four years their position is very enviable. The learned judges say that Rule 25 is mandatory and provides the only method of assessing insurance companies and as there is no 'last preceding valuation' until the first valuation is made there can be no assessment. The decision in the case was pronounced in 1933. The rule making authority has not yet made any provision for assessing the income of insurance companies before the first valuation is made. The decision in *Lakshmi Insurance Company's case* was published and adversely commented upon by us in 1932 in our *Reports of Company Cases* Vol. II at p. 39 and we find that our learned contemporary the *Madras Law Journal*, one of the most highly esteemed law Journals of India, had also criticised that decision as unsound. In *Andhra Insurance Co.'s case* referring to an observation made in *Lakshmi Insurance Co.'s case*, their Lordships say that they are in entire agreement with it. We do not think their Lordships mean to say that they agree also with the decision in that case. Anyhow, now that the Madras High Court has not expressly disagreed with the actual decision in *Lakshmi Insurance Co.'s case* and the recent decision is liable to be misconstrued as confirming *Lakshmi Insurance Co.' case*,the rule making authority should consider whether they should not make any express and clear

provisions relating to the assessment of the income of insurance companies before the first actuarial valuation.

We are reproducing here our comments on the *Lakshmi Insurance Co.'s case* published in *Reports of Company Cases* Vol. II, (1932) Editorial Notes, p. 39:

"With due respect to their Lordships, we think the decision is not sound. The words '*whose profits are periodically ascertained*' and '*by the last preceding valuation*' in Rule 25 clearly show that the rule only applies and is intended to apply to cases where an actuarial report has been prepared. Rules and bye-laws have to be construed so as not to nullify the main provisions of the Act under which they are made and we do not think there is anything in Rule 25 to exempt insurance companies from liability to pay tax before the first actuarial report. The rule is quite consistent with the view that the profits of those years must be ascertained in the way in which income for which no special method for ascertainment is prescribed, is determined."

Madras Law Journal's COMMENTS ON LAKSHMI INSURANCE CO.'S CASE.

The following Comments of the *Madras Law Journal*, Vol. 62 (1932), Notes of Indian Cases p.21 also proceed on similar lines:

"This decision may require reconsideration. The Insurance Company began its business on the 1st May, 1924, and its first actuarial report was prepared for the period ending with 30th April, 1928. The ultimate question for decision was whether the Company could be assessed to income tax on its profiits for the year 1927-28. The decision holds that it could not be by virtue of the Rule No. 25 framed by the Central Board of Revenue under Sec. 59 of the Income tax Act. The construction that has found favour with the Court is not however so obvious as their Lordships think. In terms the rule applies only to Life Assurance Companies "whose profits are periodically *ascertained* by actuarial valuation". It is difficult to see how this rule will apply to a case where admittedly no valuation has been made at all previous to the particular year. The scope of the rule is to provide for the average annual profits disclosed by the last preceding valuation, being taken to be the profits of each of the succeeding years until the next periodical valuation. The rule assumes the existence of a preceding valuation and provides for a statutory method of calculation of profit for the succeeding period. This is no doubt mandatory but only *so far as it goes*. During the ini-

tial period prior to the first valuation itself the rule can have no operation and there is no scope for its applicability. It would not follow from this that the Company's profits which are otherwise chargeable under the Act can escape assessment during that period. The effect of the non-applicability of the rule is not to exempt the Company altogether but can only be to leave the profits to be ascertained in the ordinary manner as in the absence of any rules on the point. Such profits are capable of ascertainment according to ordinary commercial methods and have been ascertained and taxed in England. Indeed the rule-making power itself need not be exercised and in such a case it cannot be held that there is no way of ascertaining the income.

It may also be noted that Sec. 59 of the Act permits rules to be made for carrying out the purposes of the Act and for the ascertainment and determination of any class of income. It may be that a rule which in effect exempts the Company from payment of tax during the years preceding its first actuarial valuation is not one authorised by the Act, unless indeed it can be held that as part of a scheme for ascertaining profits over a long period and averaging the incidence of the tax, the rule as a whole is within the ambit of the powers conferred. That apart, such an intention even if permissible can be carried out only by recasting the language of the rule and omitting the adjectival clause which limits the class of life assurance companies to which it applies. See for a somewhat analogous instance the decision in *The Vulcan Insurance Co., Ltd.* v. *The Corporation of Madras* (58 M.L.J. 337) a decision under the Madras City Municipalities Act, where however the rule in question was applicable to all companies."

We have adverted to this subject in some detail here so that the judgment in *Andhra Insurance Co.'s case* may not be miscontrued as affirming the proposition laid down, or the decision, in *Lakshmi Insurance Co.'s case.* Though the Income-tax Enquiry Committee have dealt with the assessment of insurance companies in some detail the two anomalies revealed by these decisions, viz., the *Lakshmi Insurance Co.'s case* and the *Andhra Insurance Co.'s case* do not seem to have been brought to the notice of the Committee. The matter need not go even to the Legislature. The Rule making authority itself has ample power to provide for these situations by amending Rule 25.

THE
INCOME TAX REPORTS
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[IN THE CALCUTTA HIGH COURT.]

In the matter of CHARUSILA DASSI.

SIR HAROLD DERBYSHIRE, C. J., and COSTELLO, J.

March 10, 1936.

WILL—PROVISION FOR MAINTENANCE OF WIDOW—ASSESSMENT OF WIDOW AS ADMINISTRATRIX—DEDUCTION FROM INCOME OF ESTATE OF AMOUNTS SPENT FOR HER MAINTENANCE—ASSESSMENT OF WIDOW'S PERSONAL INCOME—AMOUNT SPENT FOR HER MAINTENANCE, WHETHER ASSESSABLE—INCONSISTENT POSITIONS—REFERENCE—QUESTIONS—ABSTRACT QUESTIONS— INDIAN INCOME TAX ACT (XI OF 1922), S. 66 (2).

A will contained a provision that the testator's widow shall be suitably maintained out of his estate in the same way as she was being maintained during his lifetime. The widow obtained letters of administration and in the assessment of the income of the estate for the year 1930-31, an objection was raised by the widow as administratrix that a sum of about Rs. 10,000 shown as family expenses in the estate accounts was really amount spent by her for her maintenance etc. under the provisions of the will and as such was not the income of the estate and the said amount was excluded from the assessable income of the estate. The Income Tax Officer thereupon issued a notice under section 34 upon the widow personally stating that the sum of Rs. 10,000 had escaped assessment and ultimately made a supplementary assessment on the widow in which the amount of Rs. 10,000 was added to her income. It was contended that what the widow received was mere lodging, board

and maintenance personally to herself which from the nature of the thing cannot be turned into money and therefore was not her income. On a reference by the Commissioner: Held *in the circumstances and particular facts of the case, and having regard to the attitude adopted by the widow when she was assessed as administratrix it was not open to her in her personal assessment to say that the sum of Rs. 10,000 which was declared by her not to be part of the income of the estate, was not her income for taxation purpose.*

DERBYSHIRE, C. J.—*It was not a case of the assessee having Rs. 10,000 spent on her as board, lodging or maintenance in such a way that she was unable to turn it into money herself, but a case of income which was turned by the assessee into board, lodging and other requisits for her maintenance.*

It is undesirable that questions should be asked in an abstract form.

Cases referred to:

RAJA BEJOY SINGH DUDHURIA v. COMMISSIONER OF INCOME TAX, BENGAL, [1933] (60 I.A. 196; I.L.R. 60 Cal. 1029; 1933 I.T.R. 135; 6 I.T.C. 449).

ANGLO PERSIAN OIL CO.'S CASE [1933] (I.L.R. 60 Cal. 843; 37 C.W.N. 430; 1933 I.T.R. 129).

STATEMENT OF CASE.

"At the instance of the applicant Charusila Dassi (hereinafter referred to as the assessee) a statement of case is submitted to the Calcutta High Court for decision on the question set out in paragraph 4 below.

2. The assessee's husband, Akhoy Kumar Ghose, died on the 23rd May, 1909, leaving a will of which the assessee in due course obtained letters of administration from the Court and the assessee still continues to administer that estate under the terms of that will. By the terms of the will, the assessee was authorised to adopt a son and she accordingly adopted one Debi Prosanna Ghose who is the beneficiary of the estate. This Debi Prosanna is married and at the time material to this assessment the present assessee, Debi Prosanna Ghose and his wife were living together.

3. For the year 1930-31 an assessment was made on the estate through the present assessee as the administratrix, the total income assessed being Rs. 1,25,792. In that assessment the present assessee as administratrix claimed that a sum of approximately Rs. 30,000 shown as family expenses was really the amount spent by her on her own account under the provisions of the will and as such was not the income of the estate. As a matter of form

this amount appeared in the accounts as items of expenditure incurred by the estate and as the particular expenditure was not an allowable deduction under any of the sections of the Income tax Act the Income tax Officer did not allow any deduction on this account save an amount of Rs. 960 this being the sum to which the assessee would have been entitled if she had chosen to live apart. The assessee then preferred an appeal to the Assistant Commissioner and the Assistant Commissioner accepted the contention of the assessee ignoring the form in which the amount appeared in the account papers of the estate. He however came to the conclusion that only 1/3rd of the amount really represented assessee's drawings and consequently gave effect to her contention to that limited extent only. The result was that on the representation of this very assessee though in her capacity as administratrix the amount involved in the present assessment was treated as not being the income of the estate, it having been the income of a different person (viz., the widow of the testator, the present assessee) and consequently on the principle of the decision in *Raja Bejoy Singh Dudhuria* v. *Commissioner of Income tax, Bengal*, the assessable income of the estate was reduced by this amount on the 6th September 1931.

After this the Income tax Officer concerned, on the 14th October 1931, issued a notice on the assessee in her individual capacity and as recipient of this maintenance allowance saying that whereas he had reason to believe that assessee's income from maintenance allowance which had been assessed in the financial year ending the 31st March 1931 had partially escaped assessment he proposed to assess the said income that had escaped assessment and accordingly required the assessee to deliver to him on or before a certain date a return of her total income from all sources which were assessable in the said year ending the 31st March, 1931. (That notice took the form of saying that assessee's income from maintenance allowance had partially escaped assessment because in the original assessment a sum of Rs. 960 had been taken as assessee's income under this head, this being the sum to which the assessee would have been entitled by way of maintenance under the terms of the will, if she had lived separately from the family). On receipt of the notice under section 34 the assessee protested against the action the Income tax Officer proposed to take, in a letter dated the 18th November 1931 and it is now alleged that on receipt of that protest the Income tax Officer decided to drop the matter. There is no evidence whatever in support

of this allegation on the record and I find as a fact that the Income tax Officer gave no such promise. Unfortunately, the matter was not taken up seriously again until the 7th July 1934 when a notice was issued calling for accounts under section 22 (4) of the Act and ultimately a supplementary assessment was made on 22nd January 1935 in which this allowance of Rs. 10,000 was added to assessee's income from house property of Rs. 44,839 and tax demanded accordingly. The assessee's appeal against this supplementary assessment failed, whereupon the assessee filed an application under section 66 (2) of the Act formulating questions of law which I set out as an Appendix to this statement.

4. I do not propose to trouble their Lordships by stating a case on question (d) of that list, as this matter has already been set at rest, in so far as this province is concerned, by the decision of the Court in the case of *Anglo-Persian Oil Company* and in my view the real matters at issue in this case can be covered by the following questions:—

"Whether the amount charged upon an estate under the provisions of a will for the purpose of suitably maintaining a widow, which is actually spent for the purpose by the estate and is excluded from the income of the estate at the assessment of its income, can be treated as the income, profits or gains of the widow within the meaning of Section 4 (1) of the Income tax Act, when the widow is the administratrix and controls the expenditure of the estate including her own maintenance expenses as provided for in the will?

I refer this question only for their Lordships' decision.

5. When the appeal of the estate or of this assessee as administratrix of the estate was before the Assistant Commissioner, she claimed that a sum of Rs. 23,000 shown as expenses in the family khata should be excluded from the income of the estate as the amount received by the widow was for maintenance allowance and she was ultimately allowed Rs. 10,000 by the Assistant Commissioner; but when the widow's own personal assessment is now before me she argues, or rather her Advocate on her behalf argues, that it is impossible that the widow's maintenance allowances should run to more than a few hundred rupees annually and apparently she is determined to make the best of both worlds. Whether the allowance of Rs. 10,000 as fixed by the Assistant Commissioner is or is not unduly high is a matter which will be examined, but as the quantum of allowance is not before their Lordships, I need not trouble them with a discussion on this point.

6. The assessee's argument, I gather is that she cannot convert the benefit which she receives by reason of this clause regarding maintenance in the will, into money and that it is not reducible to a money value.

The position is not consistent with that which she took up as administratrix at the assessment of the estate. There her own case was that the same was reducible to a money value and that the amount did not form any part of the income of the estate as under the provisions of the will she as widow of the testator was entitled to divert it to her personal use out of the realization from the several sources and that as a matter of fact she did so divert the amount. This contention of hers succeeded there and after this it is no longer open to her to resile from that position.

7. The assessee meets her domestic expenditure from the funds of the estate. The household staff is paid, food-stuffs are purchased, the cost of medical treatment is met and also the cost of pilgrimages, from the estate fund. As administratrix of the estate she draws money for her own accounts as also to meet the expenses of the estate. Admittedly she draws money from the estate fund to meet her expenses when on pilgrimage and she actually handles either herself or through her servants that money in her individual capacity and pays it out as required, but in that case, it surely follows that she is receiving actual money from the estate and not merely something which is not reducible to money value. Again, if the assessee in her individual capacity has incurred an expenditure or run up a debt in the bazar, what really happens is that she in her individual capacity indents on herself in her capacity as administratrix for the money required to meet the bill or directs the manager of the estate to pay the bill on her behalf, but surely in that case, she has either received the cost of the goods constructively or by receiving the goods has received something which is reducible to money value.

8. I think the observation of their Lordships of the Privy Council in the case of *Maharaj Kumar Gopal Saran Narain Singh* v. *Commissioner of Income Tax, Bihar and Orissa,* decided on the 28th May, 1935, has some bearing on the issue arising in this case. There they observed as follows:—

"The word 'income' is not limited by the words 'profits' and 'gains'. Anything which can properly be described as income, is taxable under the Act unless expressly exempted. In their Lordships' view the life annuity in the present case is 'income' within the words used in the judgment of this Board which was

delivered in the case of *Commissioner of Income tax, Bengal* v. *Shaw Wallace and Company.*

"Here the source of the life annuity is the covenant. The life annuity is the produce of one of the items (viz., the covenant) which the appellant has taken in exchange for the estate."

I would respectfully contend that in the present case the assessee is enjoying a life annuity, the source of which is the clause in the will referred to above and the fact that the quantum of maintenance which she actually draws or the amount which she spends on herself may vary from year to year makes no real difference.

9. In my respectful opinion, therefore, the question as formulated should be answered in the affirmative.

10. A copy of their Lordships' decision may kindly be forwarded to me in due course."

C. C. Biswas for the assessee.

Advocate General and *R. C. Pal* for the Commissioner.

DERBYSHIRE, C. J.—this is a Reference by the Income tax Commissioner at the instance of the applicant Charusila Dassi, the assessee. The assessee's husband Akhoy Coomar Ghose died in May 23, 1909, leaving a will of which the assessee in due course obtained letters of administration from the Court, and at all material times she was the administratrix of her husband's estate under the terms of the will. By the will the assessee was authorized to adopt a son and she did adopt a son who is married and with his wife lives with the assessee. For the year 1930-31 an assessment was made on the estate through the present assessee as the administratrix, the total income being assessed at Rs. 1,25,792. In that assessment the assessee as administratrix claimed that a sum of about Rs. 30,000 shown as family expenses was really the amount spent by her on her own account under the provisions of the will and as such was not the income of the estate. As a matter of form this amount appeared in the accounts as items of expenditure incurred by the estate and as the particular expenditure was not an allowable deduction under any section of the Income tax Act the Income-tax Officer did not allow any deduction on this account save an amount of Rs. 960, this being the sum to which the assessee would have been entitled under the will of her husband if she had chosen to live apart.

The assessee appealed against this assessment to the Assistant Commissioner and the Assistant Commissioner accepted the contention of the assessee ignoring the form in which the amount

appeared in the account papers of the estate. He came to the conclusion, however, that only one-third of the amount really represented the assessee's drawings and consequently he gave effect to her contention to that limited extent only. The result was that because of the representation of the assessee, though it was made in her capacity as administratrix, the amount involved in the present assessment was treated as not being the income of the estate, it having been the income of a different person, namely, the widow of the testator, the present assessee, and consequently on the principle of the decision in *Raja Bijoy Singh Dudhuria* v. *Commissioner of Income-tax, Bengal* the assessable income of the estate was reduced by this amount on the 6th of September 1931.

After this the Income-tax Officer on 14th of October 1931 issued a notice on the assessee in her individual capacity and as recipient of this maintenance allowance, saying that whereas he had reason to believe that the assessee's income from maintenance allowance which had been assessed in the financial year ending 31st March 1931 had partially escaped assessment he proposed to assess the said income that had escaped assessment and accordingly required the assessee to deliver to him on or before a certain date a return of her total income from all sources which was assessable in the year ending March 31, 1931. We are told that that notice took the form of saying that the assessee's income from maintenance allowance had partially escaped assessment because in the original assessment a sum of Rs. 960 had been taken as the assessee's income under this head, this being the sum to which the assessee would have been entitled by way of maintenance under the terms of the will if she had lived separately from the family. On receipt of the notice under section 34 the assessee protested against the action that the Income tax Officer proposed to take, in a letter dated the 18th of November 1931. It is stated that the Income tax Officer thereupon decided to drop the matter. In his statement of facts the Commissioner of Income tax says: "There is no evidence whatever in support of this allegation on the record and I find as a fact that the Income-tax Officer gave no such promise." Unfortunately the matter was not taken up seriously again until the 7th July 1934 when a notice was issued calling for accounts under section 22 (4) of the Act, and ultimately a supplementary assessment was made on 22nd January 1935 in which this allowance of Rs. 10,000 was added to the assessee's income from house property of Rs. 43,839 and tax demanded accordingly. The assessee's appeal against this supplementary assessment failed where-

upon the assessee filed an application under section 66 (2) of the Act formulating questions of law which the Commissioner has set out in the Appendix. The Commissioner, however, when stating the case did not set out the questions of law as formulated by the applicant. The Commissioner said this: "I do not propose to trouble their Lordships by stating a case on question (*d*) of that list" that is, the applicant's list of questions "as this matter has already been set at rest, in so far as this province is concerned, by the decision of the Court in the case of *Anglo Persian Oil Company* and in my view the real matters at issue in this case can be covered by the following question" and that question is "whether the amount charged upon an estate under the provisions of a will for the purpose of suitably maintaining a widow, which is actually spent for the purpose by the estate and is excluded from the income, of the estate at the assessment of its income can be treated as the income, profits or gains of the widow within the meaning of section 4 (1) of the Income tax Act, when the widow is the administratrix and controls the expenditure of the estate including her own maintenance expenses as provided for in the will?" That is the only question that is referred to us.

The Income tax Commissioner in paragraph 5 of his case says: "When the appeal of the estate or of this assessee as administatrix of the estate was before the Assistant Commissioner, she claimed that a sum of Rs. 23,000 shown as expenses in the family khata should be excluded from the income of the estate as the amount received by the widow was for maintenance allowance and she was ultimately allowed Rs. 10,000 by the Assistant Commissioner but when the widow's own personal assessment is now before me she argues, or rather her Advocate on her behalf argues, that it is impossible that the widow's maintenance allowances should run to more than a few hundred rupees annually and apparently she is determined to make the best of both worlds. Whether the allowance of Rs. 10,000 as fixed by the Assistant Commissioner is or is not unduly high is a matter which will be examined, but as the quantum of allowance is not before their Lordships, I need not trouble them with a discussion on this point."

Mr. Biswas has argued the applicant's case at some length before us. His contention is what the assessee is receiving personally in this matter is lodging, board and maintenance personally to herself which from the nature of the thing cannot be turned into money and therefore is not income. Now I want to

say this: "The assessee contended or claimed before the Income-tax Officer and the Assistant Commissioner that Rs. 30,000 of what is undoubtedly the income of the estate had been allocated to her—the words are "a sum of approximately Rs. 30,000 shown as family expenses was really the amount spent by her on her own account under the provisions of the will and as such was not the income of the estate." That contention was examined by both the Income-tax Officer and the Assistant Commissioner and it was accepted by the Assistant Commissioner in principle but not as to the amount. The result was that the Assistant Commissioner accepted the applicant's contention as to a sum of Rs. 10,000 and in accordance therewith he reduced the assessment of the income of the estate. Then he claimed to reassess the assessee personally by adding to her income the Rs. 10,000 which, accepting the principle of her contention, she said was the amount spent by her on her own account under the provisions of the will. The assessee then said, or her advocate said, "That is wrong. The widow's maintenance would be something much less than that." It seems to me that the assessee having contended first that this money, whether Rs. 30,000 or Rs. 10,000 was money spent by her on her own account under the provisions of the will and therefore was not the income of the estate, it is not open to her to contend almost immediately afterwards when being assessed personally that the first contention was incorrect. I think the Income-tax authorities were entitled to disregard her second contention, but acting on her first contention, assess her in respect of Rs. 10,000. Actually in this case the assessee, an administratrix it is true, received the income of this estate Rs. 1,25,792. The assessee spent that money, in part at any rate, on the maintenance of the family establishment and in spending it she was spending it partly on her son and his wife and partly on herself. Within rather broad limits she could spend the money in such a way as she pleased partly for her own benefit and partly for the benefit of her son and his wife. Having regard to her contention it seems to me that the Rs. 10,000 were in fact her income and in fact were treated as such. She turned the money into board, lodging and the other requisites for her maintenance. It was not a case of her having Rs. 10,000 spent on her as board, lodging or maintenance in such a way that she was unable to turn it into money herself. In my view the Income-tax authorities were right in assessing her as they did.

As regards the question asked I have to point out, as I pointed

out previously) that the question is asked in an abstract form and it is undesirable that questions should be asked in that way. I have given the answer to the question that arises upon the facts of this case and the contentions raised in it.

The Income-tax Department will have their costs of this reference.

COSTELLO, J. —It is apparent that the assessee in this case was determined to make the best of both worlds as remarked in somewhat picturesque language by the learned Commissioner of Income-tax. When the assessment was made for the year 1930-31 on the estate of Akhoy Kumar Ghose through the present assessee as administratrix she then claimed that a sum of approximately Rs. 33,000 shown as family expenses was really the amount spent by her for her own purposes under the provisions of her husband's will and as such was not part of the income of the estate at all. She succeeded in getting the Income-tax authorities to accept her contention upon the basis of the principle underlying the decision in the case of *Raja Bejoy Singh Dudhuria* v. *The Commissioner of Income tax, Bengal*, but when it became the question of charging her with income-tax in respect of what I may call her aliquot part of Rs. 30,000 she then took up the attitude that no part of the Rs. 10,000 which was assumed to be her share of Rs. 30,000 could properly be considered as her own income because what she had received was something that was not reducible to money. Thus it was that she was endeavouring to "make the best of both worlds."

The question which has been propounded for our consideration assumes that there was an amount charged upon the estate of Akhoy Kumar Ghose under the provisions of his will for the purpose of the suitable maintenance of his widow the assessee. It is to be borne in mind however that a widow's claim to maintenance does not of itself constitute any charge on the estate of her deceased husband. The charge only arises either under a decree of a Court or by an agreement between the widow and the husband's representative or where there is actually a charge created by the terms of the will itself. In the present instance the relevant provision in the will was in these terms "she shall be suitably maintained out of testator's estate in the same way as she was being maintained during his lifetime and in case she did not like to live in the family, but desired to have her maintenance separately, she would get Rs. 80 per month for her maintenance, establishment and religious expenses but no other sum." Whether that provision

actually constitutes a charge on the estate or is merely a direction to the executor or administrator may perhaps be open to question. I am therefore, rather disposed to think that the hypothesis on which the question is based is not altogether accurate. The Income-tax authorities however, acted upon the assumption that the matter was covered by the decision in *Dudhuria's case* and accordingly as regards Rs. 10,000 at any rate, they thought that that was to be treated as not being part of the estate of Akhoy Kumar Ghose. We are informed that the authorities subsequently changed their view of the matter and as regards the more recent assessments they have made them on the footing that the widow's share of the expenses was in fact part of the estate of Akhoy Kumar Ghose. For our present purpose, however, we have to deal with this matter upon the footing that the Income-tax authorities rightly or wrongly did act upon the basis of the principle laid down in *Dudhuria's case* which decided that where, under a decree of a Court the entire estate of assessee both assessable and non-assessable was charged with the payment of maintenance annually to the step-mother of the assessee the sums paid to the step-mother were not income of the assessee; that they were rather the allocation of sums out of his revenue before it became income in his hands and that therefore they were not chargeable to income-tax in the hands of the Raja.

Now towards the end of his judgment Lord MACMILLAN touching upon the position of the subject matter of the charge when it came to the hands of the step-mother (at page 453 of the report) stated as follows:—"As to whether the appellant's step-mother is liable under the Act to assessment in respect of the payments received by her their Lordships, like the Judges in the Court below, deem it inadvisable to say anything." We are not in the happy position in this case in which Lord MACMILLAN found himself and we are obliged to say something on the question whether or not the Rs. 10,000 was assessable to income-tax in the hands of the widow. I agree with the learned Commissioner of Income-tax that the question which he has formulated and which we are required to answer ought to be answered in the affirmative. I arrive at that conclusion for the reasons given by my Lord the Chief Justice but mainly on the ground that in all the circumstances and on the facts of this particular case having regard to the attitude previously adopted by the assessee she ought not to be allowed and it does not lie in her mouth to say that the sum which she declared not to be part of the income of the estate is not her income for

taxation purpose when it comes into her own hands in the shape of the total sum Rs. 10,000 assumed to be her share of the domestic and other expenses.

Reference answered accordingly.

[IN THE CALCUTTA HIGH COURT.]

MESSRS. G. I. M. GREGORY & CO., *In re.*

SIR HAROLD DERBYSHIRE, C.J., COSTELLO, J., and PANCKRIDGE, J.

June 10, 1936.

FIRM—SUCCESSION—WORKING PARTNER CHANGING CAPITALIST PARTNER EACH YEAR—BUSINESS CARRIED ON IN SAME FIRM NAME—ASSESSMENT OF NEW FIRM IN RESPECT OF PROFITS OF PREVIOUS YEAR—'SUCCESSION'—'RECONSTITUTION OF FIRM' —SUCCESSION TO BUSINESS IN PART—LIABILITY OF SUCCESSOR— REFERENCE—POWER OF HIGH COURT TO LOOK INTO DOCUMENTS NOT REFERRED TO BY COMMISSIONER—QUESTION OF SUCCESSION —WHETHER QUESTION OF LAW OR FACT—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 26 (1) & (2), 66 (2).

There was a business which went by the name of Messrs. G. I. M. Gregory & Co. Until the year 1927-28, Mr. Gregory carried on this business in conjunction with one A as his partner. In 1928-29 one B joined Mr. Gregory as his partner and that constitution remained in existence up to and including the year of assessment 1931-32. The partnership agreement in each case was in force for a period of one year only and in every year a fresh agreement was executed. The last agreement with B dated July 9, 1930, was for carrying on jute business at Baira (in the district of Dacca) and at Purbadhalla (in the District of Mymensingh) and was to continue till June 3, 1931. On July 2, 1931, Mr. Gregory entered into an agreement with C for doing business at Baira for the jute season 1931-32. On July 28, 1931, he entered into another agreement with D for doing business at Mymensingh for the jute season 1931-32, but it did not last for more than a month. The sales were throughout entered into in the name and under the mark of G. I. M. Gregory & Co. which had acquired a reputation in the market

and had business connection, but no tangible assets passed from one partnership to the other. In the assessment of the firm of Messrs. Gregory & Co. as constituted by the agreement of July 2, 1931, or the year 1932-33 the question arose whether there had been a succession within the meaning of Section 26 (2) of the Indian Income Tax Act or, in the alternative, whether a change had occurred in the constitution of a firm within Sec. 26 (1) so as to justify assessment of the assessee firm in respect of the profits of the firm constituted under the deed of July 9, 1930, for the jute season 1930-31:

Held, *per* COSTELLO, J., *and* PANCKRIDGE, J. (DERBYSHIRE, C.J., *dissenting)—that the assessee firm were properly assessable in respect of the profits of the firm constituted under the deed of July 9, 1930, for the jute season 1930-31.*

Per COSTELLO, J.—*Whether there was a 'succession' within the meaning of Section 26 (2) or not, the case fell within the purview of Section 26 (1). There was throughout a firm which went on continuously year after year carrying on the business of buying and selling jute and whenever Mr. Gregory entered into an agreement with a new partner, there was merely a change in the composition and constitution of that firm within the contemplation of Section 26 (1).*

Per PANCKRIDGE, J.—*Section 26 (1) only applies when a change occurs in the constitution of a firm or a firm is newly constituted during the currency of the partnership. It has no application where the new or succeeding firm comes into existence after the term of the former partnership as in the present case owing to efflusion of time. The case was therefore really one of succession to the earlier firm constituted under the agreement of July 9, 1930, and was covered by Section 26 (2).*

Per DERBYSHIRE, C. J.—*The case was neither one of succession within Section 26 (2) nor one of reconstitution of a firm within Section 26 (1) and the assessees were not liable to be assessed in respect of the profits in question.*

COSTELLO, J.—*Though generally speaking there cannot be a succession to a part of a business, this does not imply that if what is succeeded to is not the same extent of trade or even does not include a particular line or set of customers it necessarily follows that there cannot be a succession to the trade or business; and the mere fact that the operations carried on by the transferee are not so extensive as the operations which had been previously carried on does not necessarily lead to a conclusion that there was not a succession.*

PANCKRIDGE, J.—*There may be a succession even though there is no document transferring the goodwill etc., of the old firm to the new.*

The fact that a business was intended to be carried on by the old firm in two places and only in one of those places by the new firm does not itself make the business carried on by the new firm a different business in the absence of evidence to prove a splitting up of the business.

In a reference under Section 66 (2), the High Court is entitled to took at documents and proceedings annexed to the statement of the case even though there is no specific reference to them in the body of the statement of the case.

The question of succession is at the bottom a question of fact though the question whether a particular set of facts amounts to succession within the meaning of Section 26 (2) is a question of law.

The admission and the conduct of the assessees with regard to the business may be of assistance in arriving at a decision on the point of succession.

Cases referred to :

BEHARI LAL MULLICK, *In re* (1927) (I.L.R. 54 Cal. 630; 31 C. W. N. 557; 103 I. C. 609; A. I. R. 1927 Cal. 553; 2 I. T. C. 321).

COMMISSIONER OF INCOME TAX, BOMBAY *v.* M. H. SANJANA & Co. (1926) (2 I.T.C. 110; I. L. R 50 Bom. 87; 92 I. C. 517; 27 Bom. L.R. 1471; A.I.R. 1926 Bom. 129).

COMMISSIONER OF INCOME TAX, BURMA *v.* N. N. FIRM (1933) (I.L.R. 11 Rang. 501; 1934 I.T.R. 34).

JAMES SHIPSTONE & SONS, LTD. *v.* MORRIS (1929) (14 T.C. 413).

MICHAEL FARADAY, RODGERS & ELLER *v.* CARTER (1927) (11 T. C. 565).

OGSTONE *v.* RAYNOLDS (1930) (15 T C. 501).

THOMPSON & BALFOUR *v.* LE PAGE (1923) (8 T.C. 541; 1924 SESS. CAS. 27; 61 Sc. L.R. 35).

WATSON BROTHERS *v.* LOTHIAN (1902) (4 T.C. 441; 4 F. 795; 39 Sc. L.R. 604).

WILD (H. M. INSPECTOR OF TAXES) *v.* MADAME TUSSAUD'S (1926) LTD. (1932) (17 T.C. 127).

N. C. Chatterjee with *S. B. Sinha* for the Assessees.

R. B. Pal with *R. C. Pal* for the Income Tax Commissioner.

Case stated by the Commissioner of Income Tax, Bengal, under Section 66 (2) of the Indian Income Tax Act.

STATEMENT OF CASE.

"At the request of the applicants abovenamed, a case is stated for the decision of the Hon'ble Judges of the High Court on the question of law set out in Paragraph 7 below. The matter at issue arises out of an assessment made for the year 1932-33 on the applicants abovenamed as an unregistered firm on an income of Rs. 1,00,000 earned by the purchase and sale of raw jute. For the purpose of assessment, the assessee was treated as an unregistered firm made up of G. I. M. Gregory and Messrs. Champalal Kothari, each owning an 8 annas share. A copy of the assessment order is appended (marked A). Against that assessment an appeal was filed and disposed of by an order dated 29th December 1932. In that appeal only two points were raised (1) regarding the Income-tax Officer's refusal to register the firm under Section 26-A of the Act and (2) regarding the quantum of assessment. The latter was reduced on appeal and with regard to the former, the Assistant Commissioner noted that the Income-tax Officer did not register the firm as the application filed before him was based on a partnership agreement already dissolved and at the time of assessment no partnership deed had been drawn up for the new constitution. An application for registration was filed before the Assistant Commissioner, apparently based on the new constitution, but the Assistant Commissioner refused to take action thereon holding that he had no power under the law to examine the Income-tax Officer's refusal to register. A copy of the Assistant Commissioner's order on appeal is appended (marked B). The assessee then filed an application before the Commissioner under Section 33 of the Act, copy appended (marked C), in which it was merely requested that he should allow registration of the firm as constituted at the time of assessment and on that application the Commissioner passed an order, dated the 2nd March 1933, copy appended (marked D), in which he noted that he was prepared to allow registration even at that stage if the circumstances of the case warranted it, but directed the Income-tax Officer to report after scrutiny of the relevant records, what the status of Messrs. Champalal Kothari, the other partner, was, and on receipt of that report he passed a final order, dated the 23rd March 1933, copy appended (marked E) in which he found that Mr. Gregory was, in fact, not a partner with Champalal Kothari as an individual, but with a registered firm of which Champalal Kothari is a partner and this being so, registration could not be allowed in view of the decision of the Allahabad High Court in the

case of *Jai Dayal Madan Gopal* v. *Commissioner of Income-Tax, United Provinces* (1933, 54 All. 46 : 1933 I.T.R. 186 : 6 I.T.C. 226).

2. This should ordinarily have disposed of the matter, but on the 1st June 1933 the assessee wrote a letter to the Commissioner, copy appended (marked F), claiming that this was not a case of succession under Section 26 of the Act but of discontinuance under Section 25 (3) and asking that this claim should be examined. Another case was then opened under Section 33 and after hearing the assessee an interim order was passed dated the 16th August 1933 copy appended (marked G) and a final order dated the 14th September 1933, copy appended (marked H), setting aside the assessment at the stage immediately preceding the Income-tax Officer's order, dated 27th September 1932 and directing the Income-tax Officer to proceed afresh with the assessment from that stage taking into consideration the points raised in that interim order. The matter accordingly again came before the Income-tax Officer who recorded a finding in his assessment note dated the 23rd January 1934, copy appended (marked I), that this was a case of succession under Section 26 of the Act and not a case of discontinuance in which Section 25 (3) would be applicable. The matter then came before the Assistant Commissioner on appeal, that appeal was rejected and eventually an application was filed before me under Section 66 (2) of the Act in which the five questions of law reproduced below have been formulated :—

1. When there is no transfer of assets or liabilities or goodwill and no privity of contract between Gregory-Kasera on the one hand and any party on the other, can it be held that there were any successors to the partnership consisting of Gregory and Kasera?

2. Since Gregory and Kasera operated with centres at Baira and Purbadhalla while Gregory and Kothari operated only at Baira and while Gregory and Sovachand operated at Kenduakalibari, then, if the answer to No. 1 above is in the affirmative, did Gregory and Kothari or Gregory and Sovachand succeed to a part only of business and if so is succession to a part of business, succession for the purposes of the Income-tax Act and if so how is the tax to be apportioned?

3. If it be held as is contended by the assessee that there were no successors to Gregory and Kasera, was the learned Assistant Commissioner right in holding that Section 25 (3) would not apply, in view of the fact that :

(*a*) G. I. M. Gregory & Co. paid tax under 1918 Act;

(*b*) There is no evidence of prior discontinuance;

(*c*) The taxes have been levied always in the past on the basis of continuity?

4. If it be held that Gregory and Kasera are taxable, was the learned Assistant Commissioner right in refusing registration on the ground that Messrs. Jaidayal Kasera is a firm?

5. Whether the findings of the learned Assistant Commissioner that Gregory's marks have a high value and that Sovachand's connection with Gregory lasted for 10 days only, can be supported without any evidence and against the documentary evidence adduced including a press copy of Sovachand's agreement and contracts executed in association with him which learned Assistant Commissioner admitted in evidence and allowed to be filed in the case?

I do not however propose to refer these questions; instead I refer only the question set out in paragraph 7 below, as in my view this question completely covers the matter at issue on the facts as found.

3. At this stage it would perhaps be well to set out shortly the constitution of the assessee for some years back. From the assessment year 1919-20 to 1923-24 Gregory worked in this business with one Gosto Behari Roy as partner. In 1924-25 S.B. Roy, the son, came in as a partner in place of his father and this constitution carried on till the year of assessment 1927-28. In 1928-29 Jaidayal Kasera & Co., a Marwari firm, came in as Gregory's partner and this constitution subsisted up till and including the year of assessment 1931-32. Apparently, the partnership agreement in each case was in force for only one year and every year a fresh agreement was executed. At any rate, I find in the file a partnership deed, dated the 9th July 1930 between Gregory and Jaidayal Kasera, copy appended (marked J), in which it is recorded that the agreement will be only for the jute season 1930-31.

4. The agreement between Gregory and Messrs. Champalal Kothari with which we are primarily concerned is the agreement dated the 2nd July 1931, a copy of which is appended (marked K). This agreement was to subsist for the jute season 1931-32, the purchasing centre was to be at Baira in Dacca District and according to that agreement Gregory was to receive a monthly salary of Rs. 300, while the profit at the end of the season was to be distributed half and half. Another agreement dated the 28th July 1931 was executed between Gregory and Sovachand Sohanlal, copy of which

is appended (marked L), in accordance with which they were to work as partners in a loose jute business in Kenduakalibari for the jute season 1931-32, Gregory to draw a salary of Rs. 150 per month and the ultimate profit to be shared as 4 annas to Gregory and 12 annas to the capitalist partner. That agreement subsisted only for a very short time (the Income Tax Officer says for 10 days and the assessee for one month) and when it ceased Gregory drew merely a royalty of commission from this business on the strength of the fact that the jute handled bore his business mark.

5. The assessees' case is that the law regarding succession as set out in Section 26 of the Act does not apply in this case, that every year there is a discontinuance and a new firm comes into existence, that no assets or liabilities are transferred from the old firm to the new firm, that no goodwill passes and the reputation in the market of Gregory of his mark G.I.M. & Co. stamped on jute bales has no value.

6. It is true that the purchase and sale of raw jute is a seasonal one, that business commences ordinarily in July and actively continues till the following February, that stocks of jute are sometimes carried forward to the following year and sometimes are not, and that in this particular case no stocks or assets were transferred to the new partnership business. In this connection Gregory has put on record copies of letters he has addressed to Duncan Brothers & Co., Anderson Wright & Co., and Begg Dunlop & Co., firms interested in the jute business in Calcutta, in which he has formulated the following 3 questions. (The letters and their replies are appended and marked M);—

(1) If in the Jute trade stocks of jute are carried forward by sellers from one Jute season into another:

(2) At what price reputed and well-established Jute firms sell their marks per bale as compared with prices obtainable by Messrs. G.I.M. Gregory & Co.

(3) If our Kutcha baled jute marks were put up for auction what price would they fetch.

Two of the firms replied that stocks of jute are at times carried forward by sellers from one jute season into another but one of the firms notes that this is sometimes by design, but probably more often as a result of the sellers being unable to find a market for all stocks. To the second question one firm replied that Gregory's mark is classified at annas 2 to annas 4 per maund under first-class European marks. Another replied that the Gregory mark should not be higher that that obtainable for good

Indian packing, while the third replied that well-established Europeon firms would receive annas two to annas three per maund more than the Gregory mark jute. The point really is not how the price of the Gregory mark jute would compare with the price of jute sold by well-established European firms but how it would compare with the price obtainable by Indian firms and it is perfectly clear from the answers that jute bearing the Gregory mark will fetch a higher price in the market than jute purchased by Indian financiers and sold without any mark. The third question appears to me to be really irrelevant, as the question is not what price, if any would be fetched by the Gregory jute mark if put up to auction, but what value, if any, it has in the present circumstances, when backed by Gregory's supervision and with Gregory's reputation behind it, and it is perfectly clear that it has some considerable value.

7. In this case it is clear that the trade name, and the benefit arising from the connection and reputation of Mr. Gregory have passed from the previous firm to the firm as now assessed though no tangible assets or liabilities have so passed and the question which I would state arising out of this matter may be formulated as follows :—

"Whether in these circumstances there has been a succession within the meaning of Section 26 (2) of the Indian Income Tax Act or in the alternative whether Section 26 (1) applies and on a true construction of the law applicable to the facts of this case it should be held that a change has occurred in the constitution of a firm."

8. In my respectful view, in order to constitute succession it is not necessary that any tangible assets should pass from the preceding to the succeeding firm and that in this case where the trade name, trade mark, goodwill and reputation of Mr. Gregory as a buyer of raw jute have all been taken over by the new firm, there is a succession in law within the meaning of the section. In the alternative I would argue that Section 26 (1) is applicable and that on the facts as found a change has occurred in the constitution of a firm. In other words the firm carrying on business for a number of years has been G.I.M. Gregory & Co., in which Gregory is the active partner and all that has happened is that the constitution of the firm has changed from year to year or after a number of years. That Gregory is a real partner and not a mere employee remunerated by a share of the profits is clear from the terms of the various partnership agreements as also from the fact

that his share in this business is never less than 8 annas in the rupee.

9. It is argued that because Gregory and Champalal Kothari in the year of assessment carried on a jute business in partnership, at Baira only, while in the same year Gregory for a short time carried on a jute business in partnership with Sovachand at another centre Kenduakalibari, while in the previous year Gregory had carried on a partnership business with Kasera in Baira and at one other centre other than Kenduakalibari, it follows that on the view taken by the Income-tax authorities there is here succession to a part of a business and accordingly Section 26 of the Act has no applicability. I do not accept this conclusion. The business is not that of buying jute at a particular centre or a number of particular centres in the mofussil, but the business is that of buying jute wherever it can be bought to advantage in the mofussil and selling that jute in Calcutta. We cannot isolate the purchase part of the business, as the assessee wishes us to do and treat that as the business exclusively and in my view no question of succession to a part of a business can, in the circumstances of this case, arise."

JUDGMENT.

DERBYSHIRE, C.J.—This is a case stated under Section 66 (2) of the Indian Income-tax Act, 1922, by the Commissioner of Income-tax, Bengal, for the opinion of this Court. The facts are set out in the case and in the annexures thereto. The short history of the matteris set out in paragraph 3 of the case which says: "From the assessment year 1919-20 to 1923-24 Gregory worked in this business with one Gosto Behary Roy as partner. In 1924-25 S.B. Roy, the son, came in as a partner in place of his father and this constitution carried on till the year of assessment 1927-28. In 1928-29 Jaidayal Kasera & Co., a Marwari firm, came in as Gregory's partner and this constitution subsisted up till and including the year of assessment 1931-32. Apparently the partnership agreement in each case was in force for only one year and every year a fresh agreement was executed. At any rate, I find in the file a partnership deed, dated the 9th July, 1930, between Gregory and Jaidayal Kasera, copy appended (marked J) in which it is recorded that the agreement will be only for the jute season 1930-31. The subject matter of the partnership was for buying and selling raw jute."

Paragraph 4 states: "The agreement between Gregory and Messrs. Champalal Kothari with which we are primarily concerned is the agreement, dated the 2nd July, 1931, a copy of which is appended (marked K). This agreement was to subsist for the

jute season 1931-32, the purchasing centre was to be at Baira in Dacca District and according to that agreement Gregory was to receive a monthly salary of Rs. 300/ while the profit at the end of the season was to be distributed half and half. Another agreement dated the 28th July, 1931, was executed between Gregory and Sovachand Sohanlal, copy of which is appended (marked L), in accordance with which they were to work as partners in a loose jute business in Kenduakalibari for the jute season 1931-32, Gregory to draw a salary of Rs. 150 per month and the ultimate profit to be shared as 4 annas to Gregory and 12 annas to the capitalist partner. That agreement subsisted only for a very short time (the Income Tax Officer says for 10 days and the assessee for one month) and when it ceased Gregory drew merely a royalty or commission from this business on the strength of the fact that the jute handled bore his business mark."

It is convenient at this point to refer to the agreement just mentioned. The first agreement which is dated July 9, 1930, was made between Mr. G. I. M. Gregory and Messrs. Jaydial Kasera & Co.

Paragraph 1 reads " Mr. G. I. M. Gregory and Messrs. Jaydial Kasera & Co., will work together as partners a jute business at (A) Baira (District Dacca), (B) Purbadhalla (District Mymensingh) for jute season 1930-31 in the name of Messrs. G. I. M. Gregory & Co."

Paragraph 2. " Messrs. Jaydial Kasera & Co., will supply all the working capital which will be necessary for the carrying on of the business for which they will receive interest at the rate of 9 (nine) per cent, per. annum. Mr. G. I. M. Gregory will not be expected to supply any of the working capital."

The next paragraph I want to refer to is paragraph 6 which says " All purchases of jute at the above two agencies will be made in the name of Messrs. Jaydial Kasera & Co."

Paragraph 10 provides: " Messrs. Jaydial Kasera & Co., will keep their own cashiers at the above two agencies who will handle all the money supplied by them. The cashiers will be responsible for the cash to Messrs. Jaydial Kasera & Co."

Paragraph 12 provides : " It is agreed between the parties that only a hand to mouth business will be done and the parties......... to this agreement bind themselves not to speculate."

Paragraph 14 : " The net profits at the end of jute season 1930-31 will be shared in the above two agencies in the proportion of annas 8 to Mr. G. I. M. Gregory and annas 8 to Messrs. Jaydial Kasera & Co."

The agreement dated July 2, 1931, was made between Mr. G. I. M. Gregory and Messrs. Champalal Kothari on that date.

Paragraph 1 provides: "Mr. G. I. M. Gregory and Messrs. Champalal Kothari will work together as partners a loose jute business at Baira (District Dacca) for jute season 1931-32."

Paragraph 2 provides: "Messrs. Champalal Kothari will supply all the working capital necessary for financing the business for which they receive simple interest at the rate of 9% per annum to be calculated and credited monthly on the average daily out-standing."

Paragraph 4: "No royalty will be paid to Mr. G. I. M. Gregory for the use of his marks and he will be paid a monthly salary of Rs. 300 for managing the business from Calcutta during 12 months of the year commencing July, 1931, and ending June 1932, these monthly payments to be considered a charge on the business."

Paragraph 5: All purchases of jute at the agency will be made in the name of Messrs. Champalal Kothari."

Paragraph 8: "It is agreed between the partners that only a conservative trading will be done and the parties to this agreement bind themselves not to have uncovered sales on their books at any one time exceeding 3,000 B/S and not to hold unsold stocks exceeding 1,500 B/S. These quantities may be modified or increased by the mutual consent of both parties which consent must be in writing."

Paragraph 10: Messrs. Champalal Kothari will keep their own cashier at Baira and all the Darwans will be their own men. The cashier will handle all the money supplied by them and they will be responsible for the cash to Messrs. Champalal Kothari."

Paragraph 11: "Some of the old staff of employees both up country and in Calcutta selected by Mr. G. I. M. Gregory and Messrs. Champalal Kothari that have worked for many years for Mr. G. I. M. Gregory's firm (with the exception of the cashier and Durwans vide clause 10) will be employed.",

Paragraph 13: "Sales and shipments will be made in the name of Messrs. G. I. M. Gregory and Co., under the mark of the G. I. M. Gregory and Co., and complete control of the assortment will be in the hands of Mr. G. I. M. Gregory and his representative at the agency."

The third agreement is dated 28th July, 1931, and was made between Mr. G. I. M. Gregory and Sovachand Sohanlal on that date.

Paragraph 1 provides: "Mr. G. I. M. Gregory and Sovachand

Sohanlal will work together as partners a loose jute business at Kenduakalibari for jute season 1931-32."

Paragraph 2: "Messrs. Sovachand Sohanlal agree and undertake to supply all the working capital necessary for the business for which they will receive simple interest at the rate of 8 per cent per annum."

Paragraph 4: "Mr. G.I.M. Gregory will be paid a monthly salary of Rs. 153 during the 12 months of the year 1931-32 commencing from July 1931 and ending June 1932, these payments to be considered a charge on the business."

Paragraph 7: "Rs. 65 will be paid monthly on the 4th of each month for G. I. M. Gregory's Calcutta Office expenses for the 12 months of the year from July 1931 to end of June 1932 which will be considered a charge on the business."

Paragraph 8: "All purchases of jute at the agency will be made in the name of Sovachand Sohanlal."

Paragraph 12 provides that only a conservative trading business will be done and that the parties to this agreement bind themselves not to have uncovered sales on their books at any one time exceeding 1500 bales and not at any one time to hold more than 100 bales on unsold stocks of jute.

Paragraph 15 provides: "Messrs. Sovachand Sohanlal will keep their own cashier and their own durwans at the jute agency who will handle all the money supplied by them. Mr. G. I. M Gregory will have the right to appoint 2 of his own employees at Kenduakalibari to help in the management of the business and their monthly salary will be paid by Messrs. Sovachand and will be a charge on the business."

Paragraph 18: "Sales will be made in the name of Messrs. G.I.M. Gregory & Co. and under the mark G. I. M. G. & Co. and complete control of the assortment will be in the hands of Mr. G. I. M. Gregory and his representative at the agency."

It is agreed that jute season normally ends about February of each year but that sales are frequently made after that time. The beginning of July is regarded as the beginning of the jute season.

Now I turn to paragraph 5 of the case. It says: "The assessees' case is that the law regarding succession as set out in Section 26 of the Act does not apply in the case, that every year there is a discontinuance and a new firm comes into existence, that no assets or liabilities are transferred from the old firm to the new firm, that no goodwill passes and that the reputation in the market of Gregory or his mark G.I.M.G. & Co. stamped on jute bales has no value.

Here it will be convenient to read Section 26 of the Indian Income Tax Act, 1922. Sub-section (1) provides :—" Where at the time of making an assessment under Section 23, it is found that a change has occurred in the constitution of a firm or that a firm has been newly constituted, the assessment on the firm and on the members thereof shall, subject to the provisions of this Act, be made as if the firm had been constituted throughout the previous year as it was constituted at the time of making the assessment, and as if each member had received a share of the profits of that year proportionate to his interest in the firm at the time of making the assessment,"

Sub-section (2) provides : " Where at the time of making an assessment under Section 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for the year."

Paragraph 6 of the case deals with the duration of the jute season and it says that business commences ordinarily in July and activity continues till the following February, that stocks of jute are sometimes carried forward to the following year and sometimes are not, and that in this particular case no stocks or assets were transferred to the new partnership business. In this connection Gregory has put on record copies of letters he has addressed to Duncan Brothers & Co., Anderson Wright & Co.; and Begg Dunlop & Co., firms interested in the jute business in Calcutta, in which he has formulated the following questions. (The letters and their replies are appended and marked M).

"(1) If in the jute trade stocks of jute are carried forward by sellers from one jute season into another."

"(2) And at what price reputed and well-established jute firms sell their marks per bale as compared with prices obtainable by Messrs. G. I. M. Gregory & Co."

"(3) If our Kutcha baled jute marks were put up for auction what price would they fetch."

Two of the firms replied that stocks of jute are at times carried forward by sellers from one jute season into another but one of the firms notes that this is sometimes by design, but probably more often as a result of the sellers being unable to find a market for all stocks. To the second question one firm replied that Gregory's mark is classified at annas 2 per maund under first-class

European marks. Another replied that the Gregory mark should not be higher than that obtainable for good Indian packing. While the third replied that well-established European firms would receive annas 2 to annas 3 per maund more than the Gregory mark jute. The point really is not how the price of the Gregory mark jute would compare with the price of jute sold by well-established European firms but how it would compare with the price obtainable by Indian firms and it is perfectly clear from the answers that jute bearing the Gregory mark will fetch a higher price in the market than jute purchased by Indian financiers and sold without any mark. The third question appears to me to be really irrelevant as the question is not what price, if any, would be fetched by the Gregory jute mark, if put up to auction, but what value, if any, it has in the present circumstances, when packed by Gregory's supervision and with Gregory's reputation behind it, and it is perfectly clear that it has some considerable value.'

Paragraph 7 of the case states: "In this case it is clear that the trade mark and the benefit arising from the connection and reputation of Mr. Gregory have passed from the previous firm to the firm as now assessed though no tangible assets or liabilities have so passed and the question which I would state arising out of this matter may be formulated as follows."

"Whether in these circumstances there has been a succession within the meaning of Section 26 (2) of the Indian Income Tax Act or in the alternative whether Section 26 (1) applies and on a true construction of the law applicable to the facts of this case it should be held that a change has occurred in the constitution of a firm?"

I propose to deal with those questions in the order in which they have been asked. As regards Section 26 (2) the question is has the first firm or the first partnership that was entered into on the 9th of July 1930 between Mr. G. I. M. Gregory and Messrs. Jaydial Kasera and Co. (which for the purpose of this case I will call Gregory I) been succeeded by the partnership entered into on the 2nd of July 1931 between Mr. G. I. M. Gregory and Messrs. Champalal Kothari (which for brevity's sake I will call Gregory II) within the meaning of Section 26 (2) of the Act? It has often been said by very high authorities that the English Income Tax Acts throw little light upon the Indian Income Tax Acts, but in this case Dr. Pal who appeared for the Commissioner of Income tax, Bengal, quoted to us the case of *James Shipstone & Sons, Limited* v. *Morris* reported in 14 Tax Cases at page 413 and I propose

to read an extract from the judgment of Mr. Justice ROWLATT in the case of *Ogston* v. *Raynolds* which is reported in that case. Dr. Paul drew our attention to it in the case of *Wild (H. M. Inspector of Taxes)* v. *Madame Tussaud's (1926) Ltd.*, reported in 17 Tax Cases at page 136. Mr. Justice ROWLATT said: I should like again a advert to the consideration which I drew attention to in *Shipstone* v. *Morris*, namely that this provision as regards successors is designed merely with a view to preserve in a proper case where there is a succession a measure upon which the successor may be assessed in the first year of his proprietorship of the business, and that, as I pointed out, is at the root of the necessity for there being a real continuity of the business. You want to measure the income of the successor by the past history of the business; it is therefore essential that there should be a very close identity between the business in the former proprietorship and the business in the present proprietorship." Although these words as used in the English case have reference to the English Acts they do deal with reasons underlying the provisions as regards succession in business and in my view those reasons apply to Section 26 (2) of the Indian Income Tax Act, 1922.

Now, in this case both in the firms of Gregory I and Gregory II the name was the same. Both dealt in jute. Mr. G. I. M. Gregory was the working partner and, as far as one can gather, G. I. M. Gregory's marks were used by both the firms in classifying and selling their jute. From an examination of the case and the agreements it would appear that Mr. Gregory's marks were used by each of these firms in which he had an interest and it would appear that each firm used them by licence from or express agreement with Mr. G. I. M. Gregory. There is however, one conspicuous difference between the firm of Gregory I and the firm of Gregory II. Gregory I had branches in the Dacca district at Baira and also in the Mymensingh district at Purbadhalla. The firm of Gregory II which is said to be the successor had only one branch and that branch was in the Dacca district at Baira. Whatever else it may be said that Gregory II may have succeeded to in Gregory I, Gregory II has not succeeded to the goodwill of the business done in the Mymensingh area. It would appear from the agreement of 28th July 1931 between Mr. Gregory and Sovachand Sohanlal that Mr. Gregory had agreed to allow the firm of Gregory III, *i.e.*, the partnership in the so-called business between Mr. Gregory and Sovachand Sohanlal to have the goodwill that Gregory I had in the Mymensingh area or substantially the same. The My-

mensingh area is one of the two jute areas in Bengal, the other being the Dacca area. It seems clear, therefore, that Gregory II has only succeeded to a part of Gregory I if indeed there is a succession at all in the strictest sense of the word. I am unable, therefore, to agree with the Income tax Officer that Gregory II has succeeded to Gregory I within the meaning of Section 26 (2) of the Income tax Act. In that view I am supported by the decision of Sir Arthur Page, Chief Justice of Burma, in the case of *The Commissioner of Income-tax, Burma* v. *N. N. Firm* reported in XI Rangoon at page 501. This case turned upon the application of Section 26 (2) of the Income tax Act. After stating the facts the Chief Justice said :—" Upon these facts the Income tax authorities have held that there was a 'succession' to the money-lending business of the undivided joint family within Section 26 (2) of the Income tax Act. In any opinion it is manifest that there was not a 'succession' within Section 26 (2) of the Act. In order that a person should be held to have 'succeeded' another person in carrying on a business, profession, or vocation, it is necessary that the person succeeding should have succeeded his predecessor in carrying on the business as a whole. Where a business is split up and thereafter another person carries on part of the business I am of opinion that he does not 'succeed' his predecessor in carrying on the business within s. 26 (2). Those words apply exactly to the facts of this case. I think the reason and fairness of this view is clear from the words of Mr. Justice Rowlatt in the case of *James Shipstone & Sons, Limited* v. *Morris* which I have just recited where he says " you want to measure the income of the successor by the past history of the business." In my view it is not possible to measure the income of a business carried on in the Dacca district by the history of the business when carried on as it is said it was carried on formerly in theDacca district and in the Mymensingh district and it must be remembered that in the present case the income tax authorities proposed to levy taxation on G. I. M. Gregory and Messrs. Champalal Kothari in respect of the profits thereof made out of buying and selling jute in the Dacca area on the basis of the profits that Mr. G. I. M. Gregory and Messrs. Jaydial Kasera and Co. made in the year before out of buying and selling jute not only in the Dacca area but also in the Mymensingh area. In my view the income tax authority were wrong in attempting to do this by holding that there was a succession within the meaning of Section 26 (2) and in my view it is not open on the evidence before the income tax authority to do so.

They can only do so by ignoring the goodwill of the firm of Gregory I in the Mymensingh area.

I now pass to the reasons that the Commissioner of Income Tax gives as to the attitude which the authorities take up in this matter. They are set out in para. 8 which reads : " In my respectful view, in order to constitute succession it is not necessary that any tangible assets should pass from the preceding to the succeeding firm and in this case where the trade name, trade mark, goodwill and reputation of Mr. Gregory as a buyer of raw jute have all been taken over by the new firm there is a succession in law within the meaning of the section. In the alternative I would argue that Section 26 (1) is applicable and that on the facts as found, a change has occurred in the constitution of a firm. In other words, the firm carrying on business for a number of years has been G. I. M. Gregory & Co., in which Gregory is the active partner and all that has happened is that the constitution of the firm has changed from year to year or after a number of years. That Gregory is a real partner and not a mere employee remunerated by a share of the profits is clear from the terms of various partnership agreements as also from the fact that his share in this business is never less than 8 annas in the rupee. Those words ' in this case where the trade name, trade mark, goodwill and reputation of Mr.Gregory as a buyer of raw jute have all been taken over by the new firm there is a succession in law within the meaning of the section ' deserve some consideration. The Commissioner has in my view drawn a wrong inference from the facts. The firm at Gregory I was a partnership for the jute season 1930-31. At the end of that jute season, certainly at the end of June 1931, that working partnership came to an end by the effluxion of time. With that end went the name, the right to use Gregory's trade mark and the right to the goodwill and reputation of Mr. Gregory as a buyer of raw jute. Those benefits which were clearly for the duration of the partnership went on its expiration back whence they had come—to Mr. Gregory. Mr. Gregory was on July last entitled to arrange to apply those benefits elsewhere and he did on July 2nd in the Dacca area in the partnership which he formed with Messrs. Champalal Kothari i.e., Gregory II, and on July 28th in the Mymensingh area in partnership with Sovachand Sohanlal i.e., Gregory III. Gregory II and Gregory III got those advantages by direct agreement in the one case between Gregory and Champalal Kothari and in the other case by direct agreement between Gregory and Sovachand Sohanlal. Neither Gregory II nor Gregory III succeeded to Gregory

I in these advantages. They got them as Gregory I had got them but each over a limited area, by agreement as stated above from the same source that Gregary I got them, namely, from G. I. M. Gregory. Gregory II and Gregory III never had any contractual relations with Gregory I. Gregory I was dissolved before Gregory II or Gregory III began. On the dissolution of Gregory I, G.I.M. Gregory took away what reverted to him after the life interest of Gregory I, namely, the right to use the trade mark and to form a firm in the name of G. I. M. Gregory and the benefits arising from the reputation of Gregory. After that dissolution at his own will Mr. Gregory transferred a part of what reverted to Gregory II for a limited period and a part of it to Gregory III for a limited period and in my view there was no succession at all.

As regards section 26 (1) in my view that section contemplates a business which continues in existence both during the period of the predecessor and during the period of the successor. No such business was in existence continuously during the life of Gregory I and Gregory II and in my view section 26 (1) can have no application to the facts of this case.

My answer to both parts of the question formulated in paragraph 7 of the case is 'no'.

COSTELLO, J.--I regret that I am unable to concur in the view which has just been expressed by my Lord the Chief Justice.

The question which we are required to answer was formulated by the Commissioner of Income Tax in the alternative and is in these words:

"Whether in these circumstances there has been a succession within the meaning of section 26 (2) of Indian Income Tax Act or in the alternative whether section 26 (1) applies and on a true construction of the law applicable to the facts of this case it should be held that a change has occurred in the constitution of a firm".

The first part of the question raises the problem whether or not in the circumstances of this case there was a succession within the meaning of sub-section (2) of Section 26 of the Act of 1922. In order to answer that question and indeed the second question also, it is of course necessary to consider what the facts of the case really were. They have been set out very fully in the assessment order of the 23rd January 1934. The Income Tax Officer stated (at page 19 of the paper book):

"I have gone into the matter carefully and examined the evidence produced together with books and working of the firm

both during Mr. Gregory's partnership with Messrs. Jaydayal Kasera (those books were produced in response to a notice under section 37 on Jaydayal Kasera) and with Messrs. Champalal Kothari and I am of opinion that there is a case of succession and section 26 (1) is applicable." Then he makes this comment:

"It is no doubt true that this agreement (i.e., the agreement of the 2nd July 1931) does not specifically mention G. I. M. Gregory & Co. as the name of the firm. But the internal evidence in the agreement itself would lead one irresistibly to conclude that the name of the firm carried on in co-partnership with Champalal Kothari was and could not but be G. I. M. Gregory & Co. Thus in Clause (7) of the agreement both partners are given the right to sign the firm's name. Now what is the firm's name and what name have the parties the right to sign? This must be G. I. M. Gregory & Co. otherwise there would be no meaning. Mr. G. I. M. Gregory could not possibly have been intended to be given the power of signing the name of Messrs. Champalal Kothari and all the jute activities of Messrs. Hazarimull Sardarmal were in the name of Champalal Kothari and it is absurd to think that in all the activities carried on in the name of Champalal Kothari Mr. G. I. M. Gregory should be given a hand by being empowered to sign the name. Again Champalal Kothari had automatically the power of signing his own name and it could not possibly be the intention of the agreement to empower him afresh to sign the name of Champalal Kothari."

These are some of the reasons which led the Income Tax Officer to come to the conclusion that to all intents and purposes the association of Mr. G. I. M. Gregory with Champalal Kothari was in direct succession to the association of Mr. G.I.M. Gregory with Jaydayal Kasera and that therefore one concern was in succession to the other.

I should prefer, however, to deal with this matter upon the footing that it falls within the purview of the first part of section 26. Sub-section (1) reads as follows:—

"Where, at the time of making an assessment under section 23, it is found that a change has occurred in the constitution of a firm or that a firm has been newly constituted, the assessments on the firm and on the members thereof shall, subject to the provisions of this Act, be made as if the firm had been constituted throughout the previous year as it is constituted at the time of making the assessment, and as if each member had received a share

of the profits of that year proportionate to his interest in the firm at the time of making the assessment."

In my opinion the real position having regard to the history of the matter was that there was a concern and a business which went by the name of G. I. M. Gregory & Co. That is apparent, I think, from the facts as stated in paragraph 3 of the Case put before us by the Commissioner. From the assessment year 1919-20 down to 1923-24 Mr. Gregory carried on his business in conjunction with a man named Gosto Behary Roy as his partner. In 1924-25 the son of Gosto Behari Roy came in as a partner in the place of his father and that constitution existed until the year of assessment 1927-28. Then in 1928-29 Jaydayal Kasera & Co. joined Gregory and acted as his associates or partners—if they properly can be called partners—and that constitution remained in existence up to and including the year of assessment 1931-32. It is true that the partnership agreement in each case was in force for a period of only one year and that in every year a fresh agreement was executed ; but that in my opinion really makes no substantial difference because it seems to me that G. I. M. Gregory & Co. represented by Mr. Gregory himself was perennial and indeed perpetual though the other constituent members of the "assessees" who came in from time to time were persons who came from time to time into association with Mr. Gregory and were transient and perhaps annual. In this state of things there was a firm G. I. M. Gregory & Co. which was continuously in business. The position is well described in the judgment of the Income Tax Officer at page 22 of the paper book where he says:

"One party contributed the capital and the other contributed labour and expert knowledge together with the advantage arising from the name and the mark and the profit and losses were to be shared equally between the parties and the conditions of their working together were well defined in the agreement." Then comes this observation: "Moreover the business has all along been considered as belonging to a firm with Mr. G. I. M. Gregory as one of the partners and with other financiers as capitalist partners retiring from time to time and being replaced by other capitalist partners coming in place of retiring partners. The conditions which governed the relation between the parties all along have remained almost identical. The partner Mr. G.I.M. Gregory is to always have the management of the sales effecting them in the name of G. I. M. Gregory & Co. and to lend the use of his mark "G. I. M.

Gregory & Co." to his other partners for some specified centres of purchase. These have been the conditions of the business throughout and such a business has obviously to be assessed as a firm as has all along been done. Further the business is carried on at 12, Clive Street, as admittedly the controlling power for sales is with Mr. G. I. M. Gregory at 12, Clive Street, and all cheques are made out in favour of Mr. G.I.M. Gregory & Co., although to be subsequently endorsed over to Messrs. Champalal Kothari. Besides, all claims and disputes arising from such transactions are to be settled by Mr. G. I. M. Gregory—vide clause 13 of the agreement. Hence the right place for assessment of the firm is District V, where the assessments had all along been made in the past and as a firm." So there was in the view of the Income Tax Officer a firm at any rate in a skeleton form, which carried on business at 12, Clive Street, having a number of regular customers to whom jute was sold year after year, no matter who happened to be the "financier" for the time being.

In connection with this question of continuity I should like to refer to an observation made by MACLEOD, C.J., of the Bombay High Court in the matter of *The Commissioner of Income Tax, Bombay* v. *M. H. Sanjana and Co., Ltd.*, where at page 116 the learned Chief Justice said: "As then the tax is chargeable on the profits of a business, it makes no difference if there is any change in the person who carries on the business so long as the business is continued." In the present instance in my view there was continuity as regards the business which was carried on by a firm which was known as G. I. M. Gregory & Co. and it is that firm who are the assessees with whom we are concerned. Reference has been made to the case of *James Shipstone and Sons, Limited* v. *Morris*. The first part of the judgment of Mr. Justice ROWLATT in that case is, in my opinion, very germane to the matter now before us. He said this: "The question is whether these appellants are successors to the Beeston Company. Mr. Latter very properly drew my attention to what of course we always have to bear in mind, that the condition in the Income Tax Acts about succession is to support an accurate application of the principle of measuring the profits, in a given tax year, of a business by relation to the history. The object of this and all other measuring provisions of the Income Tax Acts is not as is sometimes inaccurately pretended, to get a tax in one year upon the profits of the previous year, but it is solely to insure a proper system of measuring the tax of the year in respect of which the tax is made. Therefore,

when you are going to measure the tax of a business which has recently changed hands, you may look, under this Rule, at the history of the business and the profits in the time before the change: and that lies at the root of the consideration to which the Lord President drew attention in the case of *Watson Brothers* v. *Lothian*, that there must be a continuity of the business. I start from that." So the starting point of Mr. Justice ROWLATT was the question whether or not there was a continuity in the business which was carried on.

Now, it has been suggested as regards the question of succession that there could not be a succession in the present case because there can be no succession to a part of a business, and reference has been made to the decision of Sir ARTHUR PAGE in the case which was cited to us by Mr. Chatterji. I have no doubt whatever that it is right to say that there cannot generally speaking be a succession to a part of a business; but that, in my opinion, does not imply that if what is succeed to is not the same extent of trade or even does not include a particular line or set of customers it necessarily follows that there cannot be a succession to the trade or business, and an authority for that view of the matter is I think to be found in that very case of *James Shipstone and Sons, Limited* v. *Morris* (*ubi supra*). There is a passage in the judgment of Mr. Justice ROWLATT in that case which so fa has not been referred to. It appears at page 421 of the repor and is in these words: "Another point Mr. Latter laid some stres on was this. He said you cannot be successor to a part of a trade. He cited Mr. Justice BRAY's remarks in a case in the 'Law Times', the name of which I forget for the moment. I thinl that is quite sound when you get two parts of a trade, as an omni bus business separate from a tramway business as it may ver well be, but I do not think it means that if what is succeeded t is not the same extent of trade or even does not include a pa ticular line of customers, it necessarily follows that there canno be a successor to the trade, looking at it broadly. There must b two businesses, one left and the other taken. It does not mea to say you have only taken part of the business in the sense th what you have got is not quite so extensive as what went before.

In the light of these observations it seems to me that the me fact that the operations which were carried on by Mr. Gregory conjunction with Kothari were not so extensive as the operatio which had previously been carried on by Mr. Gregory in conjun tion with Kasera would not of itself decide the matter or entail th

we must necessarily hold that there was not a succession by Mr. Gregory and Kothari to the business previously carried on by Mr. Gregory and Kasera. I do not propose to discuss any further the question of whether or not there was a succession because as previously stated I prefer to take the view that the real position here was that all along for a great many years prior to the time of the assessment with which we are now concerned Mr. G.I.M. Gregory had been engaged in the jute business and every year had made purchase of quantities of jute in what I would call jute areas and had resold that jute to customers in Calcutta. That business was carried on from an office in Calcutta and there was a staff part of which at any rate went on year after year no matter who happened to be the persons who were financing the business in association with Mr. Gregory. Mr. Gregory was an expert buyer and he has been so described in these proceedings. The Commissioner Mr. Bown in his order said "I understand that Mr. G.I.M. Gregory is a gentleman with expert knowledge of the jute trade". Moreover, Mr. Gregory was a person possessed of sound reputation in the jute trade and had apparently a large connection with both sellers and buyers of jute. He also had the advantage of having acquired in the market a substantial reputation for his particular mark G.I.M. Gregory & Co. He carried on his operations year after year with the assistance of persons who came in to provide the necessary finance. Over a comparatively long period he was associated with one person; for a rather shorter period he was associated with somebody else; and finally came the agreement which has given rise to the present proceedings— the agreement whereby Mr. Gregory became associated with Champalal Kothari.

It is to be observed that the agreements which are before us indicate that there was really no gap at all, that is to say no period of time, even a small one, when G.I.M. Gregory and Co. was out of existence. The agreement of the 9th day of July 1930 with Jaydayal Kasera which was obviously one for a full twelve months terminated only at the very end of the month of June 1931. That is indicated by the terms of Cl. 4 of the agreement. The agreement of the 2nd day of July 1931, operated as from the very beginning of the month of July 1931. That is indicated by the provisions of Cl. 4 of that agreement. So that there was, as far as one can see, complete continuity as regards the existence of G. I. M. Gregory & Co. and that was the name under which the trading was carried on—whether the financier happened to be Kasera or whether it happened to be Kothari. As

I ventured to put it in the course of the argument financiers come and financiers go but Mr. Gregory goes on for ever to use an expression which is commonly used in pleadings in this country, "in his firm" of G.I.M. Gregory & Co. The position therefore was such that I think I ought to say, as Mr. Justice ROWLATT said in the case of *Michael Faraday, Rodgers and Eller* v. *Carter* at page 574 "it is quite out of the question that I should say that the Commissioners were wrong in point of law in saying, "why, this is one business all through."

Now, if it was one business all through even though in one year it had been operating at Baira in the Dacca District and at Purbadhalla in the Mymensingh District whereas in the succeeding year it was operating at Baira only then it seems to me that the matter certainly falls within the purview of sub-section (i) of Section 26 even if it is not posssible to say that the association or partnership of Gregory and Kothari was in succession to the association or partnership of Gregory and Kasera. According to the view which I take of the matter there was the firm of G.I.M. Gregory and Co., consisting normally of Mr. Gregory or Mr. Gregory plus another. In the year covered by the agreement of the 9th day of July 1930 the firm consisted of Mr. G. I. M. Gregory and Messrs. Jaydayal Kasera & Co. In the year following and without any lacuna at all the firm consisted of Mr. G. I. M. Gregory and Champalal Kothari. In those circumstances, it is not unreasonable and, indeed, in my view it is entirely correct to say that the position was that a change had occurred in the constitution of the firm or that a new firm had been constituted. That was the view expressed by the Commissioner of Income Tax in paragraph 8 of the case where he said " in this case where the trade name, trade mark, goodwill and reputation of Mr. Gregory as a buyer of raw jute have all been taken over by the new firm there is a succession in law within the meaning of the section. In the alternative I would argue that section 26 (1) is applicable and that on the facts as found, a change had occurred in the constitution of a firm. In other words, the firm carring on business for a number of years has been G. I. M. Gregory & Co., in which Gregory is the active partner and all that has happened is that the constitution of the firm has changed from year to year or after a number of years."

There is one other case to which I desire to refer because it is one which was referred to in the proceedings before the tribunal below—the case of *Thomson and Balfour* v. *Le Page* in which at

page 548 the Lord President said : "I do not propose to attempt a definition of 'succession' in the sense of Rule 11, but it is, I think, safe to say two things about it. In the first place, it does not include the accidental acquisition by a trader, who continues in business, of the custom left by another who goes out of business. A trader might give up or go out of the trade for some reason without attempting to realise or transfer goodwill, and the result of that might be the capture of some custom theretofore attached to him by one or more of his competitors who continued to trade. That would not, I think, be a case of 'succession' within the meaning of Rule 11. On the other hand and in the second place—I think the word 'succession' does cover any case of the transfer by one trader to another of the right to that benefit which arises from connection and reputation. The question whether there is in any particular case a 'succession' or not is a question of fact." Those observations of the learned Lord President might be sufficient to enable one to say that in the present case in all the circumstances there really was a succession. However, I will base my judgment upon the view not that there was a succession but that there was throughout a firm which went on continuously year after year carrying on the business of buying and selling jute and that whenever an agreement was entered into between Mr. Gregory and a "financier" there was merely a change in the composition and constitution of that firm within the contemplation of sub-section (1) of section 26 of the Indian Income Tax Act, 1922.

I would, therefore, say that the view taken by the Commissioner of Income Tax, Bengal, as set out in paragraph 8 of the case, at any rate so far as it relates to sub-section (1) of Section 26 is correct.

PANCKRIDGE, J.—The question of law referred to the High Court by the Commissioner of Income Tax, Bengal, under sec. 66 (2) of the Indian Income Tax Act, 1922, concerns the assessment for the tax year 1932-33 of a partnership firm known as G. I. M. Gregory & Co., consisting of one Mr. Gregory and a Marwari firm known as Messrs. Champalal Kothari and carrying on business under a deed of partnership dated July 2, 1931.

Paragraph 3 of the Commissioner's statement gives the history of the firm of G.I.M. Gregory & Co. There is no need for me to set the paragraph 3 out inasmuch as it forms part of the judgment delivered by my Lord the Chief Justice.

The relevant provisions of the deed of July 9, 1930, are the following :

The partners are to work a jute business at (A) Baira (District Dacca), (B) Purbadhalla (District Mymensingh) for the jute season 1930-31 in the name of G.I.M. Gregory & Co. The working capital is to be supplied by Messrs. Jaidayal Kasera & Co. who are to receive interest thereon at the rate of 9% per annum. Gregory is to be paid a monthly salary of Rs. 450, during the 12 months of the jute business. The nett profits at the end of the jute season 1930-31 are to be shared "in the above two agencies" in the proportion of 8 annas to Gregory and 8 annas to Messrs. Jaidayal Kasera & Co. Although the duration of the partnership is not precisely defined it is clear that the intention was that it was to continue from July 1, 1930, to June 30, 1931. I mention this because the actual business of buying and selling jute is seasonal —starting in July of one year and ending in February of the following year. A submission based on this fact was advanced at a late stage of the case to the effect that the partnership terminated in February. In view of the provision as to twelve months' salary this appears to be an impossible contention.

The arrangements made by Gregory for finance during the jute season 1931-1932 are embodied in the deed of partnership of July 2, 1931.

By this deed it is provided that Gregory and Messrs. Champalal Kothari will work as partners a loose jute business at Baira (District Dacca) for the jute season 1931-32. Messrs. Champalal Kothari are to supply the working capital and to receive interest thereon at 9%.

Clause 4 provides for Gregory's remuneration.

Clause 11 provides:

"Some of the old staff of employees both up-country and in Calcutta selected by Mr. G. I. M. Gregory and Messrs. Champalal Kothari, that have worked for many years for Mr. G. I. M. Gregory's firm (with the exception of the cashier and Durwans) will be employed."

By clause 13:

"Sales and shipments will be made in the name of Messrs. G. I. M. Gregory & Co. under the mark of the G.I.M. Gregory & Co. and complete control of the assortment will be in the hands of Mr. G.I.M. Gregory and his representatives at the agency."

Finally the profits for the jute season 1931-32 are to be divided in the proportion of 8 annas to Gregory and 8 annas to Messrs. Champalal Kothari.

A third deed of partnership dated July 28, 1931, is annexed to

the case. The parties to it are Gregory and Sovachand Sohanlal (apparently another marwari firm). The deed provides that the partners shall work together a loose jute business at Kendua Kalibari for the jute season 1931-1932. The terms of the deed need not be set out in detail. Although they differ in some respects from the terms of the deeds of July 9, 1930, and July 2, 1931, the general scheme is the same—that is to say Gregory is to work the business under the name of G.I.M. Gregory & Co. the finance being found by Sovachand Sohanlal. It should be added that Kendua Kalibari is in the district of Mymensingh.

It will be convenient to refer to G. I. M. Gregory & Co. as constituted under the deed of July 9, 1930 as the "the old firm," and to G. I. M. Gregory & Co. as constituted under the deed of July 2, 1931, as "the new firm."

The assessment on the new firm for the year 1932-33 was made under Sec. 23 (3) of the Act. In the assessment form the name of the assessee is given as "G.I.M. Gregory & Co., 12 Clive Street, Calcutta" and the names of the partners as "G.I.M. Gregory" and "Champalal Kothari."

It would appear from the form that the assessees had made a return of income, which represented Gregory's estimate of the profits of the old firm for the jute season 1930-31.

Throughout, assessment of the new firm for the tax year 1932-33 was made on the basis that it was liable to be assessed on the profits made by the old firm in the previous tax year 1931-1932, i.e., profits of the jute season 1930-1931.

According to the income tax authorities this liability arises by reason of the provisions of Sec. 26 (2) of the Indian Income Tax Act. That sub-section reads as follows:

"Where, at the time of making an assessment under section 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year."

The income tax authorities take the view that the new firm have succeeded to the business of the old firm.

There is an alternative submission that the new firm and the members thereof are assessable under Sec. 26 (1) there having been a change in the constitution of the firm within the meaning of that sub-section.

The findings of fact, the point of law for our decision, and the Commissioner's opinion thereon, are to be found in paragraphs 7 and 8. They are as follows:

"7. In this case it is clear that the trade name, the trade mark, and the benefit arising from the connection and reputation of Mr. Gregory, have passed from the previous firm to the firm as now assessed though no tangible assets or liabilities have so passed, and the question which I would state arising out of this matter may be formulated as follows:—

'Whether in these circumstances there has been a succession within the meaning of Section 26 (2) of the Indian Income Tax Act or in the alternative whether Section 26 (1) applies or on a true construction of the law applicable to the facts of this case it should be held that a change has occurred in the constitution of a firm?'

8. In my respectful view, in order to constitute succession it is not necessary that any tangible assets should pass from the preceding to the succeeding firm and that in this case where the trade name, trade mark, goodwill, and reputation of Mr. Gregory as a buyer of raw jute, have all been taken over by the new firm, there is a succession in law within the meaning of the section. In the alternative I would argue that Section 26 (1) is applicable and that on the facts as found a change has occurred in the constitution of a firm. In other words, the firm carrying on business for a number of years has been G. I. M. Gregory & Co. in which Gregory is the active partner and all that has happened is that the constitution of the firm has changed from year to year or after a number of years. That Gregory is a real partner and not a mere employee remunerated by a share of the profits is clear from the terms of the various partnership agreements as also from the fact that his share in this business is never less than 8 annas in the rupee.

The following points are taken by the assessees:

First, they emphasize the fact that no tangible assets passed from the old firm to the new. This appears to me to be a matter of very little importance. The business of G. I. M. Gregory & Co. was to buy jute and sell it at a profit in the same jute season. If at the end of one jute season there was stock to carry over to the next, that would only mean that the business had not been carried on according to plan, something untoward having happened, like overpurchasing, or default on the part of a buyer.

Next it is urged that there is no document transferring the

goodwill, the jute marks or the firm name of G. I. M. Gregory & Co. from the old firm to the new, and it is said, no doubt with accuracy that in all the reported cases where it has been held that there has been a succession there has been some documents of transfer. In my judgment it is not necessary to determine to whom the goodwill, the marks and the firm name legally belong. The important thing is that the new firm did in fact use them in their business, and each one is a factor to be taken into account in deciding whether that business was one, in respect of which the new firm should be regarded as the successor of the old. I do not think that much attention need be paid to the considerations that have weighed with English Courts, based upon the provisions of English Tax Laws, whereby an average of the profits of three preceding years is taken to be the measure of the profits of the year of tax. I say this because the scheme of the Indian Income Tax Act is different. The tax in India is paid in arrears on the profits of the previous year: not in advance on the profits of the year of assessment conventionally estimated on the basis of the profits of the previovs year, see *In the matter of Behari Lal Mullick*. In other words, the successor to a business, profession or vocation, is under a statutory liability, imposed by Section 26 (2) in respect of the profits earned in the previous year by the person he succeeds.

An argument which to my mind is of considerably greater substance is based on the fact that, whereas under the deed of July 9, 1930, the jute business of the old firm was at Baira and Purbadhalla, the jute business of the new firm was under the deed of July 2, 1931 at Baira only.

I may say I do not think that the way that the Commissioner has dealt with this point is particularly happy. He says: "The business is not that of buying jute at a particular centre, or a number of particular centres in the mofussil, but the business is that of buying jute wherever it can be bought to advantage in the mofussil and selling that jute in Calcutta."

It seems inaccurate to say that the business was that of buying jute wherever it could be bought to advantage in the mofussil, when the deed specifically provides that the business shall be carried on, in one case at Baira and Purbadhalla, and in the other case at Baira.

At the same time the fact that the business was to be carried on in the first two places during the year 1930-1931, and in the second place only during the year 1931-1932, does not in my opinion of itself make the business carried on during the second

season a different business from that carried on in the first season.

We have been referred to *The Commissioner of Income Tax, Burma* v. *N. N. Firm* (I. L. R. 11 Rangoon 501).

In that case a Hindu joint family had partitioned the joint family property by mutual consent, four of the members buying out the share of the fifth in a rice mill, which formed part of the family assets. These four thereafter worked the rice mill and carried on a money lending business under the same name and style and in the same premises, as a similar business formerly carried on by the joint family. The fifth member also carried on a money-lending business employing therein the assets he had obtained as a result of the partition. It was held that the family business had been split, and at most the four members could only be considered as succeeding to a part of it. In consequence they had not succeeded to the business within the meaning of Sec. 26 (2). In the case before us however, there is nothing to indicate splitting. It is in my opinion impossible to connect the business carried in partnership with Messrs. Sovachand Sohanlal at Kenduakalibari in 1931-32 with the Purbadhalla branch of the old firm.

With regard to the Kenduakalibari business the Commissioner observes: " The agreement subsisted only for a very short time (the Income Tax Officer says for 10 days and the assessee for one month) and when it ceased Gregory drew merely a royalty or commission from this business on the strength of the fact that jute handled bore his business mark."

Nevertheless looking only at the facts set out in the Commissioner's statement, I should hesitate to hold that they by themselves constituted " succession " within the meaning of Sec. 26 (2), and, if, there were no other materials available it might be necessary for us to refer the case back to him under Sec. 66 (4).

Counsel for the assessees argues that he we are not entitled to look beyond the Commissioner's specific findings of fact, and that, if they are not sufficient to justify his opinion, we must either refer the case back or decide in favour of the assessees. In my opinion this is an unnecessarily narrow interpretation of our powers under Sec. 66 (5). The point of law to be decided is not a hypothetical point, but a specific point raised by the facts of the particular case. The documents and proceedings annexed to the statement of the case are annexed for our consideration, and we are entitled to look at them. To shut our eyes to them because

there is no specific reference to them in the body of the statement, appears to me to be a trifle pedantic.

After all, the question of succession is at the bottom a question of fact, though the question, whether a particular set of facts amounts to succession within the meaning of the sub-section, is a question of law.

It ultimately depends on the identity of the business carried on by the assessees with the business to which they are said to have succeeded. In my judgment the admissions and conduct of the assessees with regard to the business are of the greatest assistance in arriving at a decision on this point. The more one looks at the documents, the more difficult it becomes to avoid the conclusion that the assessees never conceived that the business of the new firm was not identical with the business of the old firm, until it was pointed out to them that, if they could successfully maintain that there was no succession, they would not be liable to be assessed in respect of the profits of the old firm in the jute season 1930-31. As I have pointed out the assessees returned the income of the old firm as their assessable income. The Income Tax Officer's order shows that Mr. Gregory as representing the assessees stated that there had been a change in the firm, Messrs. Champalal Kothari having become a partner in place of Messrs. Jaidayal Kasera.

When called upon to produce the books of the old firm Mr. Gregory did not dispute their relevance, but pleaded his inability to do so, as the books were with Messrs. Jaidayal Kasera & Co. This was on September 27, 1932.

Before the Assistant Commissioner on December 29, 1932, the only points taken were the refusal of the Income tax Officer to register the assessees, and the quantum of the assessment.

On January 19, 1933, the assessees field a petition before the Commissioner asking that the mistake may be rectified " by registering your petitioners ' firm."

The language of paragraph 2 of the petition is significant :

" That your petitioners had hithertofore been always assessed as a registered firm under the Income Tax Act constituting Mr. Gregory and Messrs. Jaydayal Kasera & Co. as partners both holding equal shares in the profits as well as losses arising out of the business. The said partnership was dissolved on 30th June 1931 and succeeded over by a new firm running under the same style Messrs. G. I. M. Gregory & Co. which constituted Mr. G. I. M. Gregory and Messrs. Champalal Kothari as two partners with the privileges to enjoy equal shares in the profits and suffer the losses in

the same proportion. The fresh partnership instrument was drawn up actually on 2nd July 1931."

The petition goes no to explain that owing to a misunderstanding Mr. Gregory had incorrectly informed the Income Tax Officer on September 27, 1932, that there was no deed of partnership in respect of the new firm, whareas in fact such a deed had been executed on July 2, 1931.

It is not until June 1933 that the assessees, after taking expert advice, contended that there had been no succession.

Now I attach no importance to the use of the word "succeeding" in the petition of January 19, 1933; but taking the conduct and language of the assessees as a whole, it is to my mind perfectly clear that it never entered in the minds of the assessees that the business of the new firm was not indentical with the business of the old firm. In my opinion the assessees treated it as the same business, and it was in fact the same business. In these circumstances I hold that the opinion of the Commissioner is correct and that the assessees succeeded to the business of the firm of G. I. M. Gregory & Co., as constituted under the deed of July 9, 1930, within the meaning of Sec. 26 (2) of the Indian Income Tax Act.

I am of opinion that sub-sec. (2) is applicable rather than sub-sec. (1) because I am inclined to the view that sub-sec. (1) has only application when a change occurs in the constitution of a firm or a firm is newly constituted during the currency of a partnership and that the sub-section has no application where, as in this case the new or suceeding firm comes into existence after the term of the former partnership has come to an end owing to effluxion of time. This however is in the circumstances a question of only academic interest because in the result I agree with the opinion of Mr. Justice Costello, namely, that the assessees are properly assessable in respect of the profits of the firm of G. I. M. Gregory & Co. constituted under the deed of July 9, 1930, for the jute season 1930-31.

BY THE COURT—The answer to the first part of the question under Section 26 (2) is 'yes'. As regards the second part we must take the judgments as delivered.

Each side will pay its own costs.

Reference answered.

[IN THE LAHORE HIGH COURT.]

Rai Sahib CHIRANJI LAL & SONS

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

ADDISON, J., and DIN MOHAMMAD, J.

November 16, 1936.

FIRM—APPLICATION FOR RENEWAL OF REGISTRATION—NON-DISCLOSURE OF DEATH OF PARTNER—REFUSAL OF REGISTRATION—ASSISTANT COMMISSIONER'S POWER ON APPEAL TO DIRECT REGISTRATION—DISCRETION—INTERFERENCE BY HIGH COURT—INCOME TAX ACT (XI OF 1922), S. 26-A—INCOME TAX RULES, R. 2 (c)

The provision contained in clause (c) of Rule 2 of the Rules made by the Board of Inland Revenue under Section 59 of the Income Tax Act that an application for registration of an instrument of partnership may be made with the permission of the Assistant Commissioner hearing an appeal under Section 30, before the assessment is confirmed, reduced, enhanced or annulled, does not empower the Assistant Commissioner to order the registration of the firm himself, but only authorises him to permit the presentation of the application to the Income Tax Officer and thus to condone the delay. Further, the matter is entirely discretionary with the Assistant Commissioner and he cannot be compelled under any provision of the Income Tax Act or the Rules made thereunder to grant the prayer made to him for registration. On general principles however, the High Court is competent to determine whether the jurisdiction which is thus vested in the Assistant Commissioner under clause (c) of Rule 2 has been perversely refused.

Whether an application for renewal of registration of a firm was made after the death of one of the partners but it was stated in the application that the constitution of the firm remained the same as in the previous year and the application was consequently rejected : Held, that as there was a recital in the application which was not in accordance with facts, the application was rightly rejected.

A. M. BANJEE & SONS' CASE [1936] (8 I. T. C. 107) *followed.*

Kirpa Ram Bajaj, for the Petitioners.
J. N. Aggarwal, for the Commissioner.

ORDER.

The Commissioner of Income tax was required to state the case and refer the following question to this Court:

"Whether the Assistant Commissioner was right in refusing to register the firm?"

The facts bearing upon the question of law involved in this case are these. A firm composed of *Rai Sahib* Chiranji Lal and his four sons had been registered under an instrument of partnership dated the 17th March, 1930, and had been assessed as such until 1933-34. On the 21st May, 1934, notice was served upon the firm to furnish the usual return. On the 17th July, 1934, *Rai Sahib* Chiranji Lal died. The return was furnished on the 10th August accompanied by an application for renewal of registration, to which an undated letter was annexed, saying, that the constitution of the firm remained the same as it was declared during the previous year. This statement of fact was evidently wrong on the day on which it was made inasmuch as the constitution of the firm had changed on account of Chiranji Lal's death. On the 6th September, 1934, notice under Section 23, Sub-section (2), was served on the assessee. On the 14th September, the assessee appeared and after recording the necessary evidence an assessment order was made. At the same time the application for registration was refused. From this order the assessee preferred an appeal to the Assistant Commissioner and in addition renewed his prayer for registration of the firm. The Assistant Commissioner, however, rejected the application for registration and confirmed the assessment.

Counsel for the assessee has relied on rule 2 of the rules made by the Board of Inland Revenue under Section 59 of the Income Tax Act, 1922, the material portion of which is reproduced below:—

"Any firm constituted under an instrument of partnership specifying the individual shares of the partners may, ... register with the Income Tax Officer the particulars contained in the said instrument on application in this behalf made by the partners or by any of them.

Such application shall be made—

(*a*) * * * *

(*b*) * * * *

(*c*) With the permission of the Assistant Commissioner hearing an appeal under Section 30 before the assessment is confirmed, reduced, enhanced or annulled."

In our opinion, this rule does not help the assessee. In the first place as we read the rule, the Assistant Commissioner was not himself competent to order the registration of the firm. The only power that he could exercise, under the rule was to permit the presentation of the application to the Income Tax Officer and thus to condone the delay so to say. Further, the matter was entirely discretionary with him and he could not be compelled under any provisions of the Act or the rules made thereunder to grant the prayer made to him by the assessee. The question before us, therefore, is narrowed down to this, whether the exercise of his discretion by the Assistant Commissioner is subject to the control of this Court, and, if so, to what extent. Counsel for the assessee has not referred us to any provision of the income tax law which controls the Assistant Commissioner in the exercise of his discretion under this rule. On general principles, however, we are disposed to think that we are competent to determine whether the jurisdiction which vested in the Assistant Commissioner had been perversely refused. From this point of view, we have examined the order made by the Assistant Commissioner and have come to the conclusion that the reasons recorded by him for not granting the assessee's prayer that he could, if he so chose, grant, are not only not unsound but are cogent and convincing. In the case of *Messrs. A. M. Banjee & Sons* (8 I. T. C. 107) decided by a Special Bench of the Rangoon High Court, the learned Judges upheld the refusal of the Income Tax Officer on the ground that a recital in the application was not in accordance with facts. That case is, in our view, practically on all fours with the present case.

We accordingly answer the question referred to us in the affirmative. Costs of this reference will be paid by the assessee.

Reference answered accordingly.

The judgment in the case of *A. M. Banjee & Sons* which is referred to in the case just reported is reported below :—

[IN THE RANGOON HIGH COURT.]

A. M. BANJEE & SONS

v.

COMMISSIONER OF INCOME TAX, BURMA.

SIR ARTHUR PAGE, C. J., MYA BU AND BAGULEY, JJ.

December 10, 1934.

FIRM—APPLICATION FOR REGISTRATION—OMISSION TO DISCLOSE DEATH OF A PARTNER—REFUSAL OF REGISTRATION—INDIAN INCOME TAX ACT (XI OF 1922), SECTION 26 A.

Where one of five partners died in April, 1933, and an application was made for registration of the firm in July, 1933, in which the original 5 partners were stated to be partners and the Income Tax Officer refused registration: Held, *that the registration was rightly refused.*

Foucar, for the Assessees.

Eggar, for the Crown.

JUDGMENT.

PAGE, C. J.—The question propounded is "whether in the circumstances of this case the Income Tax Officer's refusal to register the deed of partnership was in accordance with the law."

It appears that under a deed of partnership of the 23rd March, 1932, the partnership was treated as having commenced from the 1st of January, 1932, it being a term of the agreement that the partnership should be carried on for five years from the date. The original partners in the firm were specified in the agreement as being Ahmed Mamoojee Banjee, Ismail Ahmed Banjee, Ebrahim Ahmed Banjee, Dawood Ahmed Banjee, Yusoof Ahmed Banjee.

The assessment under consideration is for the year 1933-34, the accounting period being from the 1st January, 1932 to the 31st December, 1932. There is no doubt that during the accounting period the partners in the firm were those set out in clause 4 of the deed of partnership. However, in April, 1933, Ahmed Mamoojee the father of the other four partners whose names are set out

in the deed, died, and during the year of assessment or at any rate up till the 15th of July, 1933, the conditions prescribed under Clause LL of the partnership deed had not been fulfilled. On the 15th of July, 1933 an application was made under Section 26-A of the Income-tax Act for the registration of the firm. In the application it is stated that "a certified copy of the instrument of partnership under which the firm is constituted specifying the individual shares of the partners together with a copy is enclosed. The prescribed particulars are given on the reverse." On the reverse the names of the partners are those specified in the original deed of partnership. Ahmed Mamoojee Banjee is stated therein to be one of the partners, although he had died three months before. In those circumstances the Income Tax Officer refused to register the instrument of partnership. His decision has been affirmed by the Assistant Commissioner. This is a case in which a mistake has taken place in making the application for registration, and in the circumstances I would answer the question propounded in the affirmative.

We make no order as to costs.

MYA BU, J., and BAGULEY, J., agreed with the Chief Justice.

[IN THE MADRAS HIGH COURT.]

M. KANNAPPA NAICKER & CO.

v.

COMMISSIONER OF INCOME TAX, MADRAS.

SIR H. O. C. BEASLEY, C. J., MOCKETT, J., and LAKSHMANA RAO, J.

December 18, 1936.

SUCCESSION TO BUSINESS—WHAT CONSTITUTES SUCCESSION—BUSINESS MUST BE SAME NOT MERELY SIMILAR—NEW FIRM CARRYING ON SIMILAR BUSINESS AFTER TERMINATION OF OLD BUSINESS—ASSESSMENT AS SUCCESSOR—LEGALITY—FIRM—PARTNERSHIP BETWEEN FIRM AND INDIVIDUALS—SHARE OF MEMBERS OF FIRM NOT SPECIFIED—REGISTRATION—PERMISSIBILITY—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 26 (2), 26-A.

There can be 'succession to a business' within the meaning of Sec. 26 (2) of the Indian Income Tax Act, only where the same *business is carried on by a different person, and section 26 (2) is not therefore applicable to a case where a business terminates and a different though similar business is carried on by another person or a newly constituted firm.*

The manager of a Hindu family, one M. K. N., had been for many years supplying coolies to the Madras Port Trust under contracts entered into from time to time and after his death his sons continued to supply coolies, under the name M. K. N. & Sons. Two other persons R. and G. as partners were also similarly supplying coolies to certain other godowns of the Port Trust. The contracts given to these firms expired on August 31, 1933, and the Port Trust having decided to call for tenders for a contract for 5 years, M.K.N. & Sons and R. and G. agreed to make a joint tender and to share the profits and loss in certain proportions. Their tender was accepted and they formed themselves into a new firm and supplied coolies from September 1, 1933. No assets or liabilities of M. K. N. & Sons or R. and G. passed to the new firm but business was carried on under the name M.K.N. & Co., and in the premises of M.K.N. & Sons until other premises were secured and most of the old employees were taken over. The question being whether M.K.N. & Co., were liable to be assessed for the assessment year

1934-35 under Sec. 26 (2) as successors in business to M.K.N. & Sons and R. and G.:

Held, *that the business of M. K. N. & Sons and of the firm of R. and G. had come to an end on August 31, 1933, the business carried on by M. K. N. & Co., was not the same business but a different one though similar in nature and M. K. N. & Co., could not therefore be assessed under Sec. 26 (2) as successors in business to M. K. N. & Sons and R. and G. in respect of profits which had accrued up to August 31, 1933.*

A partnership cannot be registered as a firm under Sec. 26-A of the Indian Income Tax Act where the instrument of partnership does not specify on the face of it the individual shares of the partners. Therefore, where a partnership consists of a firm and some individuals and the deed of partnership, while mentioning the proportion in which the profits and loss are to be shared between the firm and the other partners respectively, does not specify the shares of the partners of the firm which is a member of the partnership, the partnership cannot be registered as a firm under Sec. 26-A. The fact that the smaller partnership is also a registered firm and in the deed constituting that partnership the shares of its partners are specified is immaterial.

BELL *v.* NATIONAL PROVINCIAL BANK OF ENGLAND LTD. [1904] (5 Tax Cas. 1 ; 1904, 1 K. B. 149 ; 73 L.J.K.B. 142) *and*

BEST & CO. *v.* COMMISSIONER OF INCOME TAX, MADRAS [1932] (I.L.R. 55 M. 832; 138 I.C. 485; A. I. R. 1932 M. 434 ; 6 I. T. C. 271) *distinguished.*

Reference made by the Commissioner of Income Tax, Madras, under Sec. 66 (3) of the Indian Income Tax Act (XI of 1922) (O. P. No. 17 of 1936).

G. Ramakrishna Iyer and *T. Munuswami Reddi*, for the assessees.

M. Patanjali Sastri, for the Commissioner.

The facts appear in the following statement of case made by the Commissioner of Income Tax :—

STATEMENT OF CASE.

"In accordance with the High Court's order quoted above I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Section 66 (3) of the Indian Income Tax Act, 1922, hereinafter referred to as the Act."

2. The petitioners are a firm constituted under an instrument of partnership dated December 21, 1934. The partners of the firm are: (1) M. K. Naicker and Sons—a firm consisting of four part-

ners constituted under an instrument of partnership dated November 1, 1934, and hereinafter referred to as the partner firm, (2) M. Raju Naicker and (3) R. Govindarajulu Naicker. They carry on business as suppliers of labour within the jurisdiction of the Income Tax Officer, Madras I Circle.

3. Prior to September 1, 1933, the three partners of the petitioner firm were supplying labour to the Madras Port Trust under 2 separate contracts, one by partner No. 1 and the other by partners Nos. (2) and (3) as a firm. Partner No. 1 then represented a Hindu undivided family of which M. K. Naicker was the manager and was carrying on the business of supplying labour and also another business (carting contract) under the trade name "M. K. Naicker & Sons." Partners Nos. 2 and 3 were carrying on the business of supplying labour as a firm. They had no other business. The family represented by M. K. Naicker and the firm consisting of partners Nos. 2 and 3 were assessed separately till 1933-34 (previous year, calendar year 1932). The contracts for the supply of labour which the partners had with the Madras Port Trust expired on 31st August 1933 and thereafter the Port Trust decided to call for tenders for the supply of labour for a period of five years from September, 1933. The 3 partners of the petitioner firm tendered jointly for the contract in pursuance of an agreement entered into by them. A translation of the written agreement dated July 3, 1933, is filed, marked Exhibit A. They succeeded in getting the contract and accordingly continued the same business (supplying labour) which they had been doing individually till then. The firm executed a joint agreement dated 5th September 1933 with the Port Trust specifying the terms and conditions of the contract. An extract of the preamble and paragraph 28 of the agreement is filed, marked Exhibit B. Most of the employees of the business prior to September 1933 were taken over by the firm and the business was carried on in the premises of the partner firm (subsequently changed to separate premises) and under the *vilasam* " M. K. Naicker & Company."

4. M. K. Naicker died on October 4, 1934, and thereafter the joint family which consisted of his four sons became divided. These divided members constituted themselves into a firm under the old family trade name, *viz.*, M.K. Naicker & Sons and executed the deed of partnership dated 1st November 1934 mentioned in paragraph 2 (1) above. This firm and Raju Naicker and Govindarajulu Naicker, the two other partners who had jointly taken up the contract with the Port Trust, then entered into fresh partnership

evidenced by a deed dated 21st December 1934 in respect of the contract with the Port Trust for supplying labour. The other business which M. C. Naicker & Sons was carrying on, *viz.*, carting agency etc., is still continued separately by the firm M. K. Naicker & Sons. From 1st September 1933 the partners have not been carrying on labour supply business individually.

5. For the assessment of the year 1934-35 M. M. Naicker & Sons, partner No. 1, filed a return showing the income of the labour supply business carried on by them during the period 1st January 1933 to 31st August 1933, the date on which their independent contract with the Port Trust expired and their income under other heads of the year of account (calendar year 1933). They contended that the labour supply business carried on by them had been discontinued on 31st August 1933 and therefore claimed the relief provided by Section 25 (3) of the Act. Similarly partners 2 and 3 made returns for the tax year 1934-35 the year of account being the calendar year 1933 showing the income of the period 1st January 1933 to 31st August 1933 (the date of the expiry of their independent contract with the Madras Port Trust). They also contended that their business of supplying labour was discontinued on 31st August 1933 when their contract with the Port Trust expired and that therefore they were entitled to the relief provided by Section 25 (3) of the Act. The Income Tax Officer held that there was no discontinuance of the business within the meaning of Section 25 (3) of the Act but that there was a succession within the meaning of Section 26 of the Act and accordingly held that the petitioner firm was liable to be taxed in respect of the profits earned by its partners, *viz.*, M. K. Naicker, & Sons, Raju Naicker and Govindarajulu Naicker. He accordingly required the petitioner firm to make a return of its income for the tax year 1934-35. The firm filed a return declaring a loss amounting to Rs. 6,475-13 7. Since the petitioner firm's contract with the Port Trust commenced only in September 1933, they wanted "September to August" to be treated as their "previous year" for the purpose of the assessment. The Income Tax Officer allowed this and in accordance with his decision regarding succession mentioned above, he held that for the tax year 1934-35 the petitioner firm was liable to be assessed on the profits of its predecessors for the period 1st January 1933 to 31st August 1933-After examining the accounts of the partners of the petitioner firm the Income Tax Officer determined the profits of this period to be Rs. 23,064. There is no dispute now as regards the amount.

6. The petitioners applied to the Income-tax Officer for the registration of their firm " M. K. Naicker and Co." under Section 26-A of the Act, in the form prescribed by Rule 3 of the Indian Income-tax Rules, 1922, and filed a copy of the instrument of partnership dated 21st December 1934 under which the firm had been constituted. An extract of the preamble and paragraph 5 of the instrument of partnership is filed, marked Exhibit C. In the application for registration, the shares of the partners of the firm M. K. Naicker & Sons were separately shown. This was in accordance with the partnership under which that firm had been constituted. But in the deed constituting the petitioner firm the share of the four partners of the partner firm was given jointly. Since the partnership deed under which the petitioner firm had been constituted did not specify the individual shares of the partners the Income-tax Officer refused to register the firm. An extract of his order is filed, marked Exhibit D.

7. The petitioners appealed to the Assistant Commissioner but without success. An extract of his order is filed, marked Exhibit E.

8. The petitioners then filed an application under Section 66 (2) of the Act and required my predecessor to refer to the High Court three questions alleged to be questions of law. I declined to do so on the ground that no questions of law arose for decision. A copy of my order is filed, marked Exhibit F.

9. The petitioners then moved the High Court under Section 66 (3) of the Act and in its order dated 13th March 1936 the High Court has directed me to state a case and refer the following two questions :

(a) Whether on the facts of this case the assessee firm did succeed to the business of the individual partners within the meaning of Section 26 (2) of the Indian Income-tax Act ?

(b) Whether a firm constituted under a registered deed of partnership of which one member is a firm is not entitled to be registered as a firm for the purpose of income tax merely because while specifying the individual share of the profits and losses the instrument does not specify the shares inter se of the partner firm ?

Question (a). The facts found are :—

(*a*) The individual partners were separately carrying on the business of supplying labour to the Madras Port Trust until 31st August 1933. (*b*) When the Port Trust invited tenders for the supply of labour from 1st September 1933, the partners of the firm tendered jointly and secured the contract. (*c*) From 1st Septem-

ber 1933 the partners continued to carry on the same business (supply of labour to the Port Trust) jointly in accordance with the agreement dated 5th September 1933. (*d*) Most of the employees of the old business and the goodwill of the individual partners as suppliers of labour are now used for the joint business of the 3 partners in the same line. From 1st September 1933 the individual partners have not been carrying on the business of supplying labour separately either to the Port Trust or to any other person.

I am of the opinion that the facts mentioned above establish that the business now carried on by the assessee firm is identical with the business carried on by the partners individually and that it is in continuation of the individual business of the partners. The effect of the joint contract of the partners with the Port Trust is that their separate business became amalgamated into one business. Prior to 1st September 1933 the business of supplying labour to the Port Trust consisted of two units, one owned by partner No. I and the other by partners Nos. 2 and 3. After 1st September 1933, both the units are owned by the three partners jointly, no one having any exclusive ownership of any one unit. There is thus a transfer of ownership of the separate businesses from the partners concerned to the firm. This, in my opinion, amounts to "succession" within the meaning of Section 26 (2) of the Act: *Best & Co.* v. *Commissioner of Income-tax, Madras*. The question should be answered in the affirmative.

Question (*b*). The provisions regarding the registration of firms under the Act are contained in Section 26-A and Rules 2-6 of the Indian Income-tax Rules, 1922. Section 26-A and paragraph 2 of the form of application prescribed by Rule 3 require that the individual shares of the partners should be specified in the instrument of partnership which is presented for registration. In this case the partners of the petitioner firm are six in number, four of whom constitute a separate firm governed by a separate instrument of partnership. The share of the partner is 7 annas in the rupee. The shares *inter se* of the partners of the partner firm have to be ascertained from another instrument which was not presented along with the application for registration. The section clearly lays down that the share of each individual partner should be specified in the deed of partnership. Since this has not been done in this particular case, registration was rightly refused. The question should be answered in the negative.

JUDGMENT.

The questions propounded are:

"(a) Whether on the facts of this case the assessee firm did succeed to the business of the individual partners within the meaning of Section 26 (2) of the Indian Income Tax Act?" and "(b) whether a firm constituted under a registered deed of partnership of which one member is a firm is not entitled to be registered as a firm for the purpose of income tax merely because while specifying the individual share of the profits and losses the instrument does not specify the shares *inter se* of the partner firm."

Prior to the 31st August 1933 a firm called M. K. Naicker and Sons was supplying labour to the Madras Port Trust under a contract which expired on the 31st August 1933 and M. Raju Naicker and R. Govindarajalu Naicker in partnership had a similar cotract with the Madras Port Trust which also expired on the same date. The labour under the contract was supplied by the former partnership, M. K. Naicker & Sons, to two godowns belonging to the Madras Port Trust and by the latter partners to two other godowns also belonging to the Madras Port Trust. Until 1933-34 the family represented by M. K. Naicker & Sons which was an undivided family and the firm consisting of M. Raju Naicker and R. Govindarajulu Naicker were separately assessed. The managing member of the former firm had for many years been supplying labour to the Madras Port Trust under similar contracts. When the before mentioned contracts were about to expire, the Port Trust contrary to their previous practice decided to call for tenders for the supply of labour for a period of five years from September 1933, the previous practice having been to grant contracts without calling for tenders. M. K. Naicker & Sons and the other partnership decided to tender jointly for this contract in pursuance of an informal agreement entered into between them on July 3rd, 1933, in which it was agreed that if the tender should be accepted by the Port Trust, 50 per cent. of the profits and loss would be allotted to M. K. Naicker & Sons, 25 per cent. to Raju Naicker and 25 per cent. to Govindarajulu Naicker and that on acceptance of the tender a detailed partnership agreement would be executed and registered. These persons succeeded in getting the contract and accordingly jointly supplied the labour to the four godowns of the Madras Port Trust which they had previously done individually and on the 21st December 1934 executed a deed of partnership in respect of a firm styled M. K. Naicker & Co., the present petitioner M. K. Naicker

& Sons, consisting of four partners, being called the partners of the first part and Raju Naicker and Govindarajulu Naicker partners of the second and third part respectively, and their shares in the profits and losses were specified as follows: M. K. Naicker & Sons 7 annas in the rupee, Raju Naicker 5 annas in the rupee and Govindarajulu Naicker 4 annas in the rupee. Under that document the partners who are described as three in number agreed to carry on the labour supply to the Madras Port Trust in pursuance of an agreement made to M. K. Naicker & Co., with the letter dated 5th September 1933. Subsequently M. K. Naicker & Co., applied to the Income Tax Officer for the registration of the firm under Section 26-A of the Act filing the instrument of partnership already referred to, dated the 21st December 1934. The application was refused on the ground that the instrument of partnership did not specify the shares of the partners in the partnership. This point will be dealt with when we come to consider question (b) and as regards question (a) some further facts must be stated and they are that for the assessment of the year 1934-35 M. K. Naicker & Sons filed a return showing the income of the labour supply business carried on by them during the period 1st January 1933 to 31st August 1933, the date on which their independent contract with the Port Trust expired, contending that the labour supply business carried on by them has been discontinued on 31st August 1933 and therefore claiming the relief provided by Section 25 (3) of the Act. Raju Naicker and Govindarajulu Naicker made a similar return and claim. The Income Tax Officer held that there was no discontinuance of the business within the meaning of Section 25 (3) of the Act but that there was a "succession" within the meaning Section 26 (2) of the Act and held that the firm of M. K. Naicker & Co., (the assessees here) was liable to be taxed in respect of the profits earned by M. K. Naicker & Sons and the partnership of Raju Naicker and Govindarajulu Naicker. He accordingly required M. K. Naicker & Co., to make a return of its income for the tax year 1934-35. The firm filed a return declaring a loss amounting to Rs. 6,475-13-7. Since the assessee firm's contract with the Port Trust commenced only in September 1933 they required "September to August" to be treated as that "previous year" for the purposes of the assessment. This claim was allowed but the Income Tax Officer held that for the year 1934-35, M. K. Naicker & Co., was liable to be assessed on the profits of M. K. Naicker & Sons and the partnership of Raju Naicker and Govindarajulu Naicker for the period January

1933 to 31st August 1933 and he determined the profits of this period to be Rs. 23,064.

The facts have been found by the Income Tax Commissioner as follows: '(a) The individual partners were separately carrying on the business of supplying labour to the Madras Port Trust until 31st August 1933: (b) When the Port Trust invited tenders for the supply of labour from 1st September 1933, the partners of the firm tendered jointly and secured the contract: (c) From 1st September 1933 the partners continued to carry on the same business (supply of labour to the Port Trust jointly in accordance with the agreement dated 5th September 1933; (d) Most of the employees of the old business and the goodwill of the individual partners as suppliers of labour are now used for the joint business of the three partners in the same line. From 1st September 1933 the individual partners have not been carrying on the business of supplying labour separately either to the Port Trust or to any other person.' The Commissioner is of the opinion that the facts before stated by him establish that the business carried on by M. K. Naicker & Co. is identical with the business carried on by M. K. Naicker & Sons and Raju Naicker and Govindarajulu Naicker individually, that it is in continuation of the individual businesses of the partners, that the effect of the joint contract of the partners with the Port Trust is that their separate businesses became amalgamated into one business, that prior to 1st September 1933 the business of supplying labour to the Port Trust consisted of two units, one owned by M. K. Naicker & Sons and the other by Raju Naicker and Govindarajulu Naicker, that after 1st September both these units are owned by M. K. Naicker & Co., no one having any exclusive ownership of any one unit, that there is thus a transfer of ownership of the separate businesses from the partners concerned to the firm and that this amounts to "succession" within the meaning of Section 26 (2) of the Act; and in support of this opinion he relies upon *Messrs. Best & Co.* v. *Commissioner of Income Tax, Madras.*

Taking question (a) first, the relevant section is Section 23 (2) of the Act which reads as follows:—

"Where at the time of making an assessment under Sec. 23 it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year".

The requisites of that sub-section, therefore are that there must be a business in existence prior to the date of an assessment being made and that on the date of the making of the assessment it must be carried on by a different person to the person who carried it on prior to the date of the assessment, that is to say, the business must be the same but the person carrying it on must be different. For the Commissioner of Income Tax, *Bell* v. *National Provincial Bank of England Ltd.*, [5 T. C. 1] was relied upon. The question there was whether the respondent Bank which acquired by purchase the business of the County of Stafford Bank succeeded to the business of the latter Bank within the meaning of Rule 4 of the 1st and 2nd Cases of Schedule D Section 100 of the Income Tax Act of 1842 the material part of of which is similar to the sub-section in question here. On page 10 the Master of the Rolls says :

"It seems to me that the words of Rule 4 are plain, and that if the National Provincial Bank had not existed, but some new company had been formed to take over for the first time the business of the Stafford Bank, there would have been a case directly falling in terms within the words of the 4th Rule: 'If any person shall have succeeded to any trade, manufacture, adventure or concern'. In the case I put of a new company formed for the first time and acquiring the Stafford Bank, that would clearly be a case of a person succeeding to a concern. What difference does it make that that person who succeeds to the concern should himself already have an existing business? Does he the less succeed to the new business because he had the old one? It seems to me certainly not. He had the old one before. He has the old one still and the new one in addition and to that new one, it seems to me, he has succeeded".

It was accordingly held that there had been a succession within the meaning of the 4th Rule. There was a definite existing business, namely, the respondent Bank. There was also a definite and distinct business, the Stafford Bank. The former Bank became the owners by purchase of the latter. Therefore, the business of the latter was at the date of the assessment being carried on by a different body, namely, the respondent Bank and as the Master of the Rolls put it, it had clearly succeeded to that business. The present case, in our opinion, is distinguishable from *Bell* v. *National Provincial Bank of England Ltd.*, for the following reason, namely, that at the time of the purchase of the Stafford Bank it was an existing business which could and pro-

bably would have been continued under the same ownership for years. Here, the facts are entirely different and for this purpose the nature of the businesses which were going on prior to the date of the assessment in question here must be examined. Those businesses were to supply cooly labour to certain godowns belonging to the Madras Port Trust and were being conducted under contracts of specified durations. There is nothing to show that on the termination of any contracts the next contract was bound to go to either of the firms carrying on their business which it is important to note existed solely for the purposes of those contracts because it is not suggested that either of the partnerships carried on any other businesses in connection with the supply of labour except that M. K. Naicker & Sons had a small contract business. In our view, these businesses must be held to have terminated on the dates of the expiry of each contract, that is to say, the business of M. K. Naicker & Sons terminated on the 31st August 1933 and that of Raju Naicker and Govindarajulu Naicker on the same date. Reference was made by the Commissioner of Income-tax to the goodwill of these firms but we were unable to get from Mr. Patanjali Sastri any helpful reply in answer to questions put by us as to what could possibly be the goodwill attaching to such businesses. Unlike the case of the Stafford Bank, there was nothing which either of these partnerships could sell to any one for example in August 1933, or to take an earlier date, July when these two entities informally agreed to make a joint tender for the contract in question. They had no contract lasting beyond 31st August 1933 to sell, even supposing the Madras Port Trust would permit them to do so. It is conceded also that M. K. Naicker & Co. did not take over any of the assets or liabilities of the businesses carried on by M. K. Naicker & Sons and Raju Naicker and Govindarajulu Naicker, whereas in *Bell* v. *National Provincial Bank of England* the latter took over the Stafford Bank's existing business and its clients and also its premises. The Income-tax Officer's main reason for the assessment is that these persons had for several years possessed the monopoly of supplying labour to the Port Trust and finding that their monopoly was about to come to an end owing to the adoption by the Port Trust of the policy of inviting tenders and in order to secure continuity for their business they entered into a partnership and put in their tender for the contract and as they were successful they found themselves in a position to continue the business without a break. It is quite correct that they continued to supply labour to the godowns of

the Madras Port Trust as before and that what they did after 31st August 1933 was the business of the same nature as before. But in our view what the section requires is that it should be the same business and not business of the same nature and we think that this is the mistake which has been made by the Commissioner of Income-tax when he finds that " the partners continued to carry on the same business (supply of labour to the Port Trust)." This is not a case like *Messrs. Best & Co.* v. *Commissioner of Income-tax, Madras.* There Best & Co., were carrying on a number of businesses in their own name and as proprietors of concerns under different names. Amongst the latter was the Eagle Rolling Mills. This business they sold to a new company floated for acquiring it as going concern and it was held that the new company had succeeded Best & Co., within the meaning of Section 20 (2) of the Act. That was a plain case of an existing company being purchased by another as in *Bell* v. *National Provincial Bank of England Ltd.* In our view, the two businesses of M. K. Naicker & Sons and Raju Naicker and Govindarajulu Naicker came to an end on the 31st August 1933 and thereafter a new partnership (M. K. Naicker & Sons) was started to carry on a business of a similar nature. There was therefore no " succession " to a business as is required by Section 26 (2) of the Act.

There remains question (b) to be considered. The procedure relating to registration of firms is laid down in Section 26-A of the Act which is as follows :—

" (1) Application may be made to the Income-tax Officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners, for registration for the purposes of this Act and of any other enactment for the time being in force relating to income-tax or super-tax.

(2) The application shall be made by such person or persons, and at such times and shall contain such particulars and shall be in such form, and be verified in such manner, as may be prescribed; and it shall be dealt with by the Income-tax Officer in such manner as may be prescribed."

It is the former sub-section that is in question here. The application was refused on the ground that the individual shares of the partner were not specified in the instrument of partnership. The instrument of partnership as has already been stated treats the partnership of M. K. Naicker & Sons which was made up of four partners as one of the three partners in the firm of M. K.

Naicker & Co., and to this partnership a 7 annas share in the rupee in the profits and losses is given. The contention of Income-tax authorities is that as M. K. Naicker & Sons consists of four partners, the shares of each of them should have been set out in the partnership deed (Ex. C). The shares of the partners in M. K. Naicker & Sons were each Re. 0-1-9 totalling 7 annas and as that partnership had previously been registered, a reference to the instrument relating to it, a copy of which was filed with the Income tax authorities, would show this. Not only would the Income tax authorities be aware of the shares of the partners—and it is conceded that they did know—but the application for registration itself set out the individual shares of the partners of M. K. Naicker & Sons. Notwithstanding this knowledge, the Income tax Officer—and his action has been upheld by the Commissioner—presumably took the view that he was rigidly bound by the words of the section and that as in the instrument of partnership these individual shares were not given, registration must be refused. The object in requiring this information is in order that the Income tax authorities may determine what the profit received by each of the partners from the partnership profits is and in order to prevent the profits from being distributed to the partners otherwise than in accordance with the shares of the partners as shown in the instrument of partnership registered under the Act and to prevent any partner returning his income below its real amount. We think that this is a hard case in view of the fact that Income tax authorities were really aware of the shares of the partners; but the words of the subsection do not seem to us to permit of any elasticity of construction. Section 28 (2) also points to the same conclusion. The individual shares of the partners must be specified in the instrument of partnership. They were not. That being so, the Income tax Officer could refuse registration on that ground. The answer to this question, therefore must be in the negative.

As regards costs, as the main contention has been upon question (a) and the assessees have succeeded, in our opinion they are entitled to the costs which we fix at Rs. 250. The Rs. 100 deposited by the assessees is ordered to be refunded to them.

[IN THE LAHORE HIGH COURT.]

SARDAR KIRPAL SINGH and others
v.
COMMISSIONER OF INCOME TAX, PUNJAB.

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

November 26, 1936.

REFERENCE—QUESTION OF LAW—QUESTION WHETHER THERE IS EVIDENCE TO SUPPORT A FINDING OF FACT—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 66 (2).

Whatever conclusions are arrived at by the income tax authorities, they must have some material to support them and in case it is contended that there is no material for those conclusions, the question resolves itself into one of law.

Application under Section 66 (3) of the Indian Income Tax Act to direct the Commissioner of Income Tax, Punjab, to state the case and refer certain questions of law to the High Court, in the matter of the assessment of Sardar Kirpal Singh and others for the year 1934-35. Civil Mis. Application No. 336 of 1936.

Mehr Chand Mahajan, for the assessees.
Jagannath Aggarwal and *S. M. Sikri*, for the Commissioner.

ORDER.

The assessees in this case required the Commissioner of Income Tax under Sub-section (2) of Section 66 of the Income Tax Act to refer to the High Court several questions of law arising out of the appellate order of the Assistant Commissioner of Income Tax in the matter of their assessment for the year 1934-35. Thereupon, the Commissioner drew up a statement of the case and referred the following three questions to this Court.

(1) Was there no material upon which the Assistant Commissioner could uphold the finding that *Sardar* Kirpal Singh and his three brothers constituted a Hindu undivided family ?

(2) Was there no material upon which the Assistant Commissioner could uphold the finding that each of the sources of income comprised in the assessment belonged to the said family ?

(3) Was assessment upon the said family not validly based upon notices addressed to *Sardar* Kirpal Singh without specification of status ?

Not being satisfied with the statement of the case made by the Commissioner and the questions referred to us, the assessees moved this Court under Section 66 (3) praying that the Commissioner be called upon to refer certain other questions of law also that arose in their assessment.

The facts bearing upon the questions of law involved in this case may shortly be stated. Jawanda Mal and his four sons were assessed as a Hindu undivided family up to 1927. In the meantime, they had opened a branch of their business in London. On the 15th March 1927, they formed themselves into a company. Out of the four sons of Jawanda Mal, Balwant Singh was for the time being excluded; the other three sons had a share each, Jawanda Mal had four and the three ladies of the family had a share each. This company was duly registered on the 10th June 1927. Later, Balwant Singh, too, applied for a share and one share was allotted to him on the 24th June 1927. Soon after, Jawanda Mal died, leaving besides other property a sum of Rs. 1,77,000 odd. On the 15th January 1928, the sons of Jawanda Mal divided this cash among themselves in the following manner:—

Each son was allotted 400 shares of Rs. 100 each, thus disposing of Rs. 1,00,000. The balance which amounted to Rs. 17,000 odd was deposited with the company in the name of *Mussammat* Dhan Devi, the widow of Jawanda Mal, at a fixed rate of interest.

After 1928, the Income tax authorities treated the four brothers as individuals apart from their company. On the 1st February 1930, the brothers opened a branch of their business at Colombo. No change in their status took place up to 1934. In the 1934-35 assessment, however, the question was taken up for the first time, whether they could claim to be assessed as individuals and not as members of a Hindu undivided family, and decided against them. The Income Tax authorities have not only assessed them as Hindu undivided family but also treated the sum deposited in the name of their mother, *Mussammat* Dhan Devi, as a part of the joint family property and to the profits made by the company within British India, they have added Rs. 10,000 as profits received from Colombo and London.

The additional questions proposed by the assessees relate to the inclusion of their mother's deposit in the so-called joint family property and the addition of Rs. 10,000 to the income of the said family on account of their profits on Colombo and London business. The only other point raised by the assessees is as to the form of question No. 3 referred to above.

After hearing counsel on both sides, we are satisfied that the questions proposed by the assessees do arise in this matter and that the question No. 3 formulated by the Commissioner also requires alteration on the lines proposed by them. Whatever conclusions are arrived at by the Income tax authorities, they must have some material to support them, and in case it is contended that there is no material for those conclusions, the question does resolve itself into one of law. We accordingly formulate the following two questions in addition to the three questions referred to us by the Commissioner:—

(4) Whether there is no material for the finding that the deposit held by *Mussammat* Dhan Devi in the Pioneer Sports, Limited, was not her separate property?

(5) Whether the Income Tax Officer was legally justified in raising a presumption that any income was received in India from Colombo or London?

Besides we alter question No. 3 in the following manner:—

(3) Whether the notices which issued to the four brothers were sufficient notice to the Hindu undivided family, if any, having regard to Sections 2 (9), 3 and 63 (2)?

The alteration has been necessitated on account of the argument advanced by the assessees' counsel that a notice served on an individual is not a valid notice to a family.

We accordingly require the Commissioner to refer to this Court the two additional questions of law also as formulated above and the third question in its altered form and to draw up a statement of the case in relation thereto and refer it with his own opinion thereon to this Court. There will be no orders as to the costs of this petition.

Petition allowed.

[IN THE LAHORE HIGH COURT.]

GANGA RAM BALMOKAND

v.

COMMISSIONER OF INCOME-TAX, PUNJAB, N. W. F. P., AND DELHI

AND

KISHEN CHAND BHOLA NATH

v.

COMMISSIONER OF INCOME-TAX, PUNJAB, N. W. F. P., AND DELHI.

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

November 25, 1936.

ACCOUNT BOOKS—BOOKS REJECTED AS UNRELIABLE—ASSESSMENT UNDER SEC. 23 (3)—ASSESSMENT MUST BE BASED ON EVIDENCE NOT CONJECTURES—RAISING AMOUNT OF SALES AND APPLYING FLAT RATE—LEGALITY—QUESTION OF LAW—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 13 and 23 (3).

Where an Income Tax Officer rejects the account books of an assessee as unreliable he has power to make an assessment under the proviso to Section 13 of the Income Tax Act in such manner as he may determine and he may make his own estimate of the income in such a case, but if after rejecting the assessee's accounts the Income Tax Officer proceeds to make an assessment not under Section 13 but under Section 23 (3), his estimate must be based on evidence and not on conjectures.

Where the income tax authorities after rejecting the account books of an assessee increased the sales from Rs. 3,14,456 to Rs. 3,50,000 and applied a flat rate of 7 per cent. on the sales and the assessee contended that these estimates were based on conjectures and not on evidence, the High Court directed the Commissioner to state the case and refer the question 'whether there was no material for the finding of the income tax authorities, arrived at under Sec. 23 of the Act, that the sales should be raised from the figure shown in the books to Rs. 3,50,000 and that the correct flat rate for the calculation of profit was 7 per cent. on the sales.'

Though where the principle of assessment at a flat rate is not contested its amount would be for the income tax authorities to determine as a question of fact, this rule does not apply where the

method of assessment at a flat rate is itself objected to by the assesssee.

FEROZE SHAH v. COMMISSIONER OF INCOME TAX, PUNJAB [1933] (1933 I.T.R. 219; 60 I.A. 325; 14 Lah. 682; 144 I.C. 686; A.I.R. 1933 P.C. 198) distinguished.

Application under Section 66 (3) of the Indian Income Tax Act, 1922, to require the Commissioner of Income Tax, Punjab, to state the cases and refer certain questions to the High Court.

[Civil Miscellaneous Nos. 273 and 384 of 1936.]

Kirparam Bajaj, for the Assessees.

Jagannath Aggarwal and *M. Sikri*, for the Commissioner.

ORDER.

C. M. P. No. 373 of 1933.

The firm Ganga Ram Balmokand has applied to this Court under the provision of Section 66 (3) of the Income Tax Act for a mandamus to issue on the Commissioner of Income Tax, requiring him to state the case of the assessee for the year 1933-34 and to refer it for the orders of this Court.

The assessee has a head office and four factories. From 1928-29 to 1932-33, the trading accounts of the assessee were accepted and they disclosed the following flat rates of profit, namely:

1928-29............	8. 6	per cent.
1929-30............	8. 9	per cent.
1930-31............	5. 7	per cent.
1931-32............	4. 65	per cent.
1932-33............	5. 8	per cent.

In the 1933-34 assessment, which is in dispute, the rate disclosed was 3 per cent. and the books were scrutinised, the reason given for this being that the rate per cent. of profit was out of all proportion to the average rates of profits made by other persons in the same trade.

The Income Tax Officer then found that the trading account was not supported by a stock book but was based on the inventory system, under which the quantity and valuation of opening and closing stocks could easily be manipulated, directly affecting the net profits, and that in such an account a portion of the sales could be kept out of the books without leaving any chance for their detection and that in this way profit could be very easily concealed. During the investigation the assessee alleged that the balance-sheets were prepared every year on pieces of paper which were destroyed, no copy being retained and that though he had four factories for the manufacture of soap, he kept no accounts

showing their individual activities, that no record was maintained of the raw material supplied to each factory or of the manufactured goods received therefrom. It was further alleged that all purchases and sales were made by the head office and that each factory drew raw material without any record and the head office sent a man with each purchaser to the factory, the goods being delivered without any record at the factory. These allegations were not believed and they are certainly unusual.

The Income-tax Officer, therefore, on the facts before him rejected the evidence of the books, holding them to be false and cooked and not representing in fact a true and complete version of both sides of the transaction as they actually occurred in the course of business. He, therefore, increased the sales shown in the books from Rs. 3,14,456 to Rs. 3,50,000 which he estimated would account for the concealed transactions. He further applied a flat rate on these sales of 7 per cent. to arrive at the profit.

The assessee objected to the Commissioner that this was not a proper method for assessment under Section 23 (3) of the Act and asked that the case be referred to this Court. The Commissioner refused this application and the assessee has come here with a request that he be required to state the case.

The Commissioner has made it quite clear that the proviso to Section 13 was not applied in this case.

This proviso runs as follows :—

"Provided that, if no method of accounting has been regularly employed or if the method employed is such that, in the opinion of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom, then the computations shall be made upon such basis and in such manner as the Income tax Officer may determine".

"Possibly it may be the case that on the facts found by the Income-tax Authorities the second part of this proviso may apply but that matter does not appear to arise in this case as the Commissioner has unequivocally stated that it has not been applied and that the decision was a decision under Section 23 (3) of the Act on the merits. According to Section 23 (1) if the Income-tax Officer is satisfied that a return made under Section 22 is correct and complete, he shall assess the total income of the assessee and shall determine the sum payable by him on the basis of such return. According to Section 23 (2) if the Income-tax Officer has reason to believe that a return is incorrect or incomplete he shall serve on the person who made it a notice requiring him either to attend at the Income-tax Officer's office

or to produce or to cause to be there produced any evidence on which such person may rely in support of the return. Then comes Section 23 (3) to the effect that on the day specified in the notice or later the Income-tax Officer, after hearing such evidence as such person may produce and such other evidence as the Income-tax Officer may require, shall by an order in writing, assess the total income of the assessee, and determine the sum payable by him on the basis of such assessment. We are not here concerned with Section 23 (4).

It was contended before us that, this being an assessment under Section 23 (3), the Income-tax authorities had to come to a decision on evidence and that this was not done in the present case. It was assumed for the purpose of the argument that the books were properly rejected though they had been accepted for the five preceding years. It was argued, however, that there was no evidence, on which the Income-tax authorities could raise the amount shown in the books from Rs. 3,14,456 to Rs. 3,50,000 or on which they could apply a flat rate of 7 per cent. on the sales to arrive at the profit. It was contended that the addition to the sale and the flat rate applied were merely estimates or conjectures of the Income-tax authorities, not based on any evidence before them. If, of course, the books had been rejected under the second part of the proviso to Section 13, the Income-tax Officer had power to assess in such manner as he could determine, and this would certainly allow an estimate to be made; but this is not the case of the Income-tax authorities, the Commissioner clearly stating that it was a case of action under Section 23 (3), that is, a decision on the merits.

We were referred to the Privy Council case *Feroze Shah* v. *Commissioner of Income-tax, Punjab.* There the first question was whether a sum of Rs. 90,618 being credit sales for which cash was said not to have been received during the account year should have been included in the assessment for the year in question or in the next year and it was held that there was evidence for the finding of the Income-tax authorities that the objected item was excluded from the accounts out of ordinary course and for reasons not to be justified. In these circumstances it followed that the decision of the Income-tax authorities was final. The second question before their Lordships in that case was whether a flat rate in the absence of profit and loss account was justified and it was held that, where the principle of assessment at a flat rate in the absence of profit and loss account was not contested, its amount would be for the

Income-tax Officer to determine as a question of fact. This is undoubtedly a correct exposition of the law, but in the present case the assessee appears to have objected to the method of assessment at a flat rate throughout the proceedings. His books have been rejected by the Income-tax authorities but it is contended that there is no evidence by which a flat rate can be held established or in accordance with which the amount shown in the books could be raised to the figure estimated by the Income-tax Officer. It seems to us that this is therefore a case which should be referred to us and we require the Commissioner to state the case of the assessee for the assessment year 1933-34, and to refer the following question namely :—

"Whether there was no material for the finding of the Income-tax authorities, arrived at under Section 23 (3) of the Act, that the sales should be raised from the figure shown in the books to Rs. 3,50,000 and that the correct flat rate for the calculation of profit was 7 per cent. on the sales ?"

There will be no costs of this petition.

C.M.P. 384 of 1936

ORDER—The firm Kishen Chand Bhola Nath has applied for a mandamus to issue upon the Commissioner of Income-tax to state the case of the assessee firm for the year 1933-34, and to refer it to this Court for decision.

This case is in essence the same as Civil Miscellaneous No. 273 of 1936, decided today, except that in the present case the only question is as to the application of a flat rate of 7 per cent. on the sales to estimate the profits. For the reasons given in the case already mentioned we require the Commissioner to state the case of the assessee and to refer the following question to this Court, namely :—

"Whether there was no material for the findings of the Income-tax authorities, arrived at under Section 23 (3) of the Act, that the correct method of estimating the profits of the assessee was to apply a flat rate of 7 per cent. to the sales shown in the books. There will be no costs of this application."

Applications allowed.

[IN THE MADRAS HIGH COURT.]

CHENGALVAROYA CHETTIAR
v.
COMMISSIONER OF INCOME TAX, MADRAS.

SIR H. O. C. BEASLEY, C.J., MOCKETT, J., & LAKSHMANA RAO, J.

December 4, 1936.

BUSINESS EXPENDITURE—LEASE GRANTING EXCLUSIVE PRIVILEGE OF EXCAVATING LIME SHELLS—PROVISION FOR PAYMENT OF CERTAIN SUM IN SEVERAL INSTALMENTS—AMOUNTS SO PAID, WHETHER CAPITAL EXPENDITURE OR BUSINESS EXPENDITURE—RECITAL OF 'ANNUAL LEASE AMOUNT,' EFFECT OF—FIRM—DISCONTINUANCE BEFORE ASSESSMENT OF TAX—LIABILITY OF PARTNERS TO BE ASSESSED JOINTLY AND SEVERALLY ON PROFITS OF FIRM—"TAX PAYABLE", MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), Sec. 10 (2) (ix), Sec. 44.

The assessee obtained from the Secretary of State for India the exclusive privilege of excavating lime shells within a certain area for three years under a lease deed which provided inter alia, *that "the lessee shall pay the sum of Rs. 30,450 in twelve equal instalments payable in advance on the 21st day of July and October 1930, January, April, July and October 1931, January, April, July and October 1932, and January and April 1933, the annual lease amount being Rs. 10,150 in consideration of the aforesaid exclusive privilege having been granted to him":*

Held, *on a reference by the Commissioner of Income tax, that the sum of Rs. 30,450 paid by the assessee to the Government of India under this instrument of lease was a capital expenditure, and that the statement in the deed that the annual lease amount was Rs. 10,150 did not alter its nature and make it revenue expenditure.*

CHENGALVAROYA MUDALIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS [1934] (1934 I.T.R. 395; 7 I.T.C. 323) *applied.*

Section 44 of the Income Tax Act, which provides that where any business, profession or vocation carried on by a firm has been discontinued every person who was at the time of such discontinuance a member of such firm shall be jointly and severally liable for the amount of the tax payable in respect of the income, profits and gains of the firm, is not confined in its application to cases where an assessment had been made before the discontinuance of the firm.

The words "tax payable" in the said section mean tax which the firm or partnership would be liable to pay if it had not been discontinued, tax either found to be due already or that will be found to be due in the future.

Reference made by the Commissioner of Income Tax, Madras, under Sec. 66 (2) of the Indian Income Tax Act of 1922. [O. P. No. 187 of 1936].

M. Subbaraya Iyer, for the Assessee.

M. Patanjali Sastri, for the Commissioner.

The facts are stated in the following statement of case made by the Commissioner of Income tax.

STATEMENT OF CASE.

I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Section 66 (2) of the Indian Income Tax Act (XI of 1922) hereinafter referred to as the Act).

2. The petitioners who constituted a firm were carrying on business in excavation and sale of chunam shells within the jurisdiction of the Income tax Officer, Madras III circle. They entered into separate leases, one with the Government and the other with the Venkatagiri Samasthanam, by which they obtained the privilege of excavating chunam shells from certain lands belonging to the lessors. The leases were for a period of 3 years and expired in 1933. But the business continued till about May 1934 when the last stock was disposed of. The partners did not however settle their accounts till about July 1935 and the firm became finally dissolved before the close of 1935.

3. For the tax year 1934-35 (previous year, calendar year 1933) the firm was originally assessed on a total income computed at Rs. 21,749 on the 4th December 1934. The firm disputed the correctness of the method followed by the Income-tax Officer in computing its income and filed an appeal to the Assistant Commissioner. But the Assistant Commissioner overruled the firm's contentions and dismissed the appeal by his order dated 8th February 1935. The petitioner firm did not raise any objections to the assessment as confirmed by the Assistant Commissioner.

4. Subsequently on 27th March 1935 the Income tax Officer found that in computing the income as above the amount paid by the petitioner firm to the lessors, *viz.*, Rs. 30,450 to the Government and Rs. 43,987 to the Venkatagiri Samasthanam had been wrongly allowed in view of the decision of the Madras High Court

in *Chengalvaroya Mudaliar* v. *Commissioner of Income Tax* (7 *I.T.C.* 323). He accordingly started proceeding under Sec. 34 and served a notice on the petitioner firm on 29th March 1935. The petitioner firm then made a return showing a loss of over Rs. 30,000 and in regard to the proposal to make a supplemental assessment in respect of the lease amounts originally allowed as expenditure contended that the decision of the High Court mentioned above had no application to this case.

5. A copy of the instrument of lease dated 2nd July 1930 under which the sum of Rs. 30,450 was paid to the Government is filed marked Exhibit A. By clause (ii) of this agreement the petitioner agreed with the Revenue Divisional Officer to have the exclusive privilege of excavating chunam shells within the area specified in the agreement from 1st July 1930 to 30th June 1933 both days inclusive. Clause (iii) of the agreement runs as follows :—

"The lessee shall pay into the Sub-Treasury at Sulurpet or at any Government Treasury the sum of Rs. 30,450 (Rupees Thirty thousand four hundred and fifty) in twelve equal instalments payable in advance on the 21st day of July and October 1930, January, April, July, and October 1931, January, April, July and October 1932, and January and April 1933, the annual lease amount being Rs. 10,150 (Rupees Ten thousand and one hundred and fifty) in consideration of the aforesaid exclusive privilege having been granted to him".

The agreement contained other clauses which are not relevant for a consideration of the point at issue in this case. The payments in question, *viz.*, Rs. 30,450 were made on the dates specified in the agreement.

After hearing the petitioner firm's advocate the Income tax Officer held that the sums paid to the Government and the Venkatagiri Samasthanam ought to be treated as capital expenditure. He therefore added Rs. 74,437 to the income originally assessed and made a supplemental assessment accordingly on 23rd December 1935. The notice of demand was served on one of the partners on the 10th January 1936.

7. The petitioner firm appealed to the Assistant Commissioner and contended among other things

(1) that the amount paid to the lessors was a deductible item of expenditure and

(2) that the petitioner firm ha[illegible]issolved no assessment should have been made on the [illegible] and that separate

assessments, if any, should have been made on the individual partners of the firm on their respective shares in the profits of the business.

The Assistant Commissioner allowed Rs. 43,987 paid to the Venkatagiri Samasthanam and overruled the petitioner firm's objection in respect of the disallowance of Rs. 30,450. He accordingly reduced the assessment to Rs. 52,199. On contention (2) above he held that the assessment had been correctly made. An extract from his order is filed marked Exhibit B.

8. The petitioner firm now requires me to refer to the High Court 3 questions marked 1, 2 and 3 in the application for reference. I consider it unnecessary to refer question (3) in view of a prior decision of this court reported at 2 I.T.C. 104, *Commissioner of Income-tax* v. *Krishna Chandra.* I accordingly refer questions (1) and (2) which are as follows:—

(1) Whether the sum of Rs. 30,450 paid by the assessee to the Government under the instrument of lease dated 2nd July 1930 is inadmissible as a revenue expenditure;

(2) Whether after dissolution of the partnership the Income-tax Officer had jurisdiction to assess the firm as a unit and whether Section 44 of the Act gives jurisdiction to the officer both to make a joint and single assessment or whether the individual partners alone are liable to be assessed in respect of their proportionate shares.

Question (1). The facts of this case are similar to those in Chengalvaroya Mudaliar's case, decided by this Court (*supra*). The amount payable to the Government was a lump sum of Rs. 30,450 and what the petitioner firm obtained in return was the exclusive right to excavate chunam shells within a specified area for a specified period. As in the case mentioned above the payments in question were not made as an outlay in an already acquired business, in order to carry it on and to earn a profit out of this expense as an expense of carrying it on: but were made to acquire the business. The payments cannot be regarded as representing the cost of the shells excavated as they were not based on the quantity of shells excavated and were not in any way dependent on any excavation being made at all. The fact that the agreement mentions Rs. 10,150 as the "annual lease amount" does not in my opinion distinguish this case from Chengalvaroya Mudaliar's case mentioned above. The lease was for a period of 3 years and the amount payable to Government was a lump sum for the whole period, though it was made payable in 12 equal

instalments, as in Chengalvaroya Mudaliar's lease (Please see paragraph 3 of the agreement in that case Exhibit A--7 I.T.C. 323 at page 325). The facts of this case being substantially the same as those in the case mentioned above, the question should, in my opinion, be answered in the affirmative.

Question 2. It is not disputed that during the 'previous year' in question the petitioner firm carried on a business and made profits therefrom. Under Section 3 of the Act such profits are liable to be assessed in the name of the firm. The Income Tax Officer started proceedings in time by serving the necessary notice on the firm but before he could complete the assessment the firm was dissolved. The notice of demand was therefore served on one of the ex-partners. The question arises whether the assessment made under such circumstances is legal. It appears to me that Section 44 of the Act was intended to meet such a case, and that it imposes a liability on the partners of a defunct firm to submit to an assessment made in the name of the firm. It will be noted that this section forms part of Chapter V which is headed "Liability in special cases." The argument on behalf of the petitioners is that this section merely provides for recovery from the ex-partners of tax imposed on the firm before its dissolution. But if this were so the provision would naturally occur in Chapter VI (headed "Recovery of Tax and Penalties") and not in Chapter V; and moreover this section regarded as mere machinery for collection is otiose for when an assessment has been made on the firm the tax demanded is a debt due by the firm, and the partners after dissolution are under the general law (Contract Act, Section 249, now Section 25 of the Indian Partnership Act) jointly and severally liable for all such debts. It appears to me therefore that this section like the other sections in the same chapter of the Act creates a liability to assessment. The profits to be assessed, according to the section, are those of the firm, and the tax due on such assessment may be recovered from any or all of the ex-partners.

EXHIBIT A.

Agreement this second day of July 1930 between P. T. Chengalvoraya Chettiar (hereinafter called the lessee) of the one part and the Right Honourable The Secretary of State for India in Council (hereinafter called the Secretary of State) of the other part.

Whereas the lessee has agreed with the Revenue Divisional Officer acting for and on behalf of the Secretary of State to have exclusive privilege of excavating chunam shells within the following area in the Block No. VIII Western foreshore of Sriharikoto Islands, Nellore District from the 1st day of July 1930 to the 30th day of June 1930 (both days inclusive); And whereas the Lessee has lodged with the Deputy Tahsildar Sulurpet the sum of Rs. 3,045 (Rupees Three thousand and forty five) as security for the due and faithful performance by the lessee of this his contract, now these presents witness that for carrying the said agreement into execution the Lessee on the one part for himself his heirs executors administrators representatives and assigns and the Revenue Divisional Officer on the other part on behalf of the Secretary of State his successors and assigns do hereby mutually contract and agree as follows.

3. The lessee shall pay into the Sub-Treasury at Sulurpet or at any Government Treasury the sum of Rs. 30,450 (Rupees Thirty thousand four hundred and fifty) in twelve equal instalments payable in advance on the 21st day of July and October 1930, January, April, July and October 1931, January, April, July and October 1932 and January and April 1933, the annual lease amount being Rs. 10,150 (Rupees Ten thousand and one hundred and fifty) in consideration of the aforesaid exclusive privilege having been granted to him.

4. The Lessee shall pay interest at six per cent. per annum on any or all sum or sums which may be due by him under this agreement and which he may fail to pay on the date or dates on which the same may respectively be or become due.

5. In the event of the lessee failing to pay within fourteen days of the date or dates on which they may be or become due any sum or sums payable by him under this agreement the same may be recovered as an arrear of land revenue under Madras Act II of 1864 or other law for the time being in force for the recovery of arrears revenue.

[The remaining portion of the document is not material for the purposes of this report—Ed.]

JUDGMENT.

Two questions have been referred to us by the Commissioner of Income-tax, *viz.*,

"(1) Whether the sum of Rs. 30,450 paid by the assessee to the Government under the instrument of lease dated 2nd July 1930 is inadmissible as revenue expenditure; and (2) whether after dissolution of the partnership the Income-tax Officer had jurisdiction to assess the firm as a unit and whether Section 44 of the Act gives jurisdiction to the officer both to make a joint and single assessment or whether the individual partners alone are liable to be assessed in respect of their proportionate shares."

With regard to question No. 1, the facts are quite sufficiently stated by the Commissioner of Income-tax in his letter of reference, but quite briefly they are that the assessee by a deed dated the 2nd July 1930 got the exclusive right to excavate shells lying under Government property for three years for a payment of Rs. 30,450 payable by certain instalments and described in the instrument as regards Rs. 10,150 (being one third of the amount stated) as "the annual lease amount." This sum of Rs. 30,450 was originally allowed to be deducted by the Income-tax Officer as being a payment out of revenue and not a capital expenditure. Subsequently, having regard to this High Court's decision in *U. Chengalvaroya Mudaliar* v. *The Commissioner of Income Tax, Madras*, that allowance was cancelled and the sum was treated as a capital expenditure in the hands of the assessee. Hence this reference. In our view, the facts of this case are not distinguishable from the facts in Chengalvaroya Mudaliar's case. There it was held that having regard to the instrument, the expenditure was an initial expenditure without which the assessee could not even have begun winning the shells and it was therefore, a capital expenditure. We have had addressed to us a strenuous argument by Mr. Subbaroya Ayyar that there is a very material distinction between the words in the instrument in this case to those in Chengalvoraya Mudaliar's case. He contends that as the words "annual lease amount" appear in the instrument in question here and do not appear in the instrument in Chengalvaroya Mudaliar's case it renders the agreement in question a rental agreement and that full significance must be given to the words "annual lease amount" and they must be taken as showing that the payment to be made under the instrument was a payment by way of rent and therefore a revenue expenditure and not a capital expenditure as in Chengalvaroya Mudaliar's case. We are unable

unable to see that those words make any material difference. The transaction in question is exactly the same as that in Chengalvaroya Mudaliar's case and the use of the words, "annual lease amount" does not, in our opinion, alter its nature. The answer to the first question must be in the affirmative.

With regard to the second question the assessment here was made by the Income Tax authorities under Section 44 of the Act which reads as follows:

"Where any business, profession or vocation carried on by a firm has been discontinued, every person who was at the time of such discontinuance a member of such firm shall be jointly and severally liable for the amount of tax payable in respect of the income, profits and gains of the firm."

The object of that section is perfectly clear. It is to enable the tax on the profits of a firm which has been discontinued to be got by the Income-tax authorities and to prevent the avoidance of taxation by the discontinuance of the firm. The words are, in our opinion, perfectly clear but Mr. Subbaroya Ayyar contends that unless an assessment upon the firm has already been made before its discontinuance, which is not the case here the partners of it cannot be assessed jointly after its discontinuance, because according to him the words "tax payable" in the section mean "payable as the result of an assessment already made upon the firm". If this contention is correct it leads to a strange result. The object of the section being perfectly clear, *viz.*, to get at the tax on the profits of the firm made before its discontinuance, and bearing in mind that that is its object, the result of the contention, if correct, would be that the tax recoverable would be less than that recoverable if the businesss had not been discontinued. In such a case the tax would have been upon the profits of the business but if a separate assessment is made upon the partners separately and not jointly after the discontinuance of the business it is conceded that the tax recoverable would be less. We are unable to see why the fact that an assessment has not been made upon the firm previous to its discontinuance should bring about such a result. It seems to us that "tax payable" means "tax that is due to be paid", "tax which the firm or partnership would be liable to pay if it had not been discontinued"; "tax either found to be due already or that will be found to be due in the future". That being so, we are clearly of the opinion that the Income Tax

authorities were correct in assessing the partners of the discontinued firm jointly and severally in respect of the profits earned by the firm before it was discontinued. Question No. 2 is answered accordingly. The Income-tax Commissioner will get Rs. 250 costs.

Reference answered.

[IN THE MADRAS HIGH COURT.]

RAJA OF BOBBILI

v.

COMMISSIONER OF INCOME TAX, MADRAS.

SIR H. O. C. BEASLEY, C. J., MOCKETT, J., AND

LAKSHMANA RAO, J.

December 4, 1936.

IMPARTIBLE ESTATE—HOLDER OF ESTATE, WHETHER LIABLE TO BE ASSESSED AS INDIVIDUAL OR AS REPRESENTATIVE OF HINDU UNDIVIDED FAMILY—INDIAN INCOME TAX ACT (XI OF 1922), S. 3.

The income of an impartible estate belongs absolutely to the holder of the estate for the time being, and the holder of such an estate is, therefore, liable to be taxed in respect of the income of the estate as an individual and not as the representative of a Hindu undivided family.

Cases referred to:

BAIJNATH'S CASE [1921] (I.L.R. 43 All. 228; 48 I.A. 195; 60 I.C. 534; 19 A.L.J. 317; 23 Bom. L.R. 654; 25 C.W.N. 564; 40 M.L.J. 387).

COLLECTOR OF GORAKHPUR *v.* RAM SUNDER MAL, [1934] (I.L.R. 56 All. 468; I.A. 286; 150 I.C. 542; 1934 A.L.J. 779; 36 Bom. L.R. 867; 38 C.W.N. 1101; 67 M.L.J. 274; A.I.R. 1934 P.C. 157).

COMMISSIONER OF INCOME-TAX, BIHAR AND ORISSA *v.* MAHARAJ KUMAR VISHESWAR SINGH [1935] (I.L.R. 14 Pat 785; 1935 I.T.R. 126; 8 I.T.C. 295; 166 I.C. 116).

COMMISSIONER OF INCOME-TAX, *v.* ZEMINDAR OF CHEMUDU, [1934] (I.L.R. 57 Mad. 1023; 1934 I T.R. 288; 67 M.L.J. 406).

JAGADAMBA KUMARI *v.* WAZIR NARAIN SINGH, [1928] (I.L.R. 2 Pat. 319; 50 I.A. 1; 77 I.C. 1041; 44 M.L.J. 503; 25 Bom. L.R. 676; 28 C.W.N. 98).

JANAKI PRASAD SINGH v. DWARAKA RRASAD SINGH, [1913] (I.L.R. 35 All. 311; 40 I.A. 105; 19 I.C. 267; 11 A.L.J. 494; 15 Bom. L.R. 502; 17 C.W.N. 853; 25 M.L.J. 111).

KISHAN KISHORE v. COMMISSIONER OF INCOME-TAX [1933] (I.L.R. 14 Lah. 255; 1933 I.T.R. 143; 141 I.C. 416).

PARBATI KUMARI DEBI v. JAGADISH CHUNDER DEBAL [1902] I.L.R. 29 Cal. 433; 29 I.A. 82; 6 C.W.N. 490).

PITTAPUR CASE [1899] (I.L.R. 22 Mad. 283).

RAJANI KANTA PAL v. JAGAN MOHAN PAL [1923] (I.L.R. 50 Cal. 439; 50 I.A. 173; 73 I.C. 252; 25 Bom. L.R. 683; 27. C.W.N. 997; 44 M.L.J. 561).

SARTAJ KUARI'S CASE [1888] (I.L.R. 10 All. 272; 15 I.A. 51)

SECOND PITTAPUR CASE [1918] (I.L.R. 41 Mad. 772).

SHIBA PRASAD SINGH v. PRAYAG KUMARI DEBEE [1932] (59 Cal. 1399).

SIR RAJA SHIVA PRASAD SINGH v. THE CROWN [1924] (I.L.R. 4 Pat. 73; 82 I.C. 653; A.I.R. 1924 Pat. 679).

Case stated by the Commissioner of Income-tax, Madras, under Section 66 (2) of the Indian Income-tax Act, Act XI of 1922 [O. P. No. 224 of 136].

STATEMENT OF CASE.

V. Govindarajachari, for the assessee.

M. Patanjali Sastri, for the Commissioner.

I have the honour to refer the following case for the decision of the Honourable Judges of the High Court under Section 66 (2) of the Income-tax Act (XI of 1922).

2. The petitioner is the Rajah of Bobbili, the present holder of the Impartible Estate of Bobbili. During the 'previous year' (1st April 1934 to 31st March 1935) he was also the Chief Minister to the Government of Madras. He is, besides, the managing member of a Hindu undivided family, of which he and his brother are the senior coparceners.

3. For the assessment year 1935-36 his total income from all sources liable to income tax was ascertained to be Rs. 64,083 made up of the following items:

1. Salaries	Rs. 49,399
2. Interest on securities	420
3. Property	8,446
4. Business; Moneylending (Rs. 998) and Kerosene oil agency Rs, 525)	1,523

5. Other sources: Dividends (Rs. 540) and quarries and fisheries (Rs. 3,755) 4,295

Rs. 64,083

He was assessed on the above income both to income tax and supertax. Supertax was levied as on an individual, the amount treated as exempt being Rs. 30,000.

4. Of the figures given above, items (1) and (2), Rs. 10 out of item (3), Rs. 525 out of item (4) (representing income from kerosene and petrol agency) and Rs. 540 out of item (5) (representing dividends) are found and admitted to be income accruing to the petitioner as an individual and not to the joint family of which he is a member. The remaining sums, *viz.*, Rs. 8,436 from property, Rs. 998 from money lending business and Rs. 3,755 from other sources (fisheries and quarries) are income derived from the impartible estate. The petitioner contends, on this ground, that they are income of the joint family. He claims that the above items of income should not have been included in this assessment which is one made on the Rajah as an individual.

5. As the authorities below have disallowed the contention, the petitioner requires me to refer to the High Court two questions of law marked (a) and (b) in the application for reference. As the questions in the form framed by him are not suitable for reference, I have reframed them with the consent of the petitioner's Advocate into a single question as shown below and refer it accordingly for the decision of the High Court.

Question. "Whether in respect of the following three sums, *viz.*, Rs. 8,436 being income assessable under the head 'property' Rs. 998 under 'business' and Rs. 3,755 under other sources (quarries and fisheries) the petitioner was rightly taxed as an individual or whether he should have been taxed as the representative of a Hindu undivided family".

6. The point to be decided is whether the income derived by the Rajah from the impartible estate is income of the joint family of which the Rajah is the manager. The petitioner's contention is based on the doctrine that an impartible estate, the holder of which belongs to a joint family, is the property of the family. In my opinion that is stated too broadly. It would be more accurate to say that for certain limited purposes the law requires the estate to be dealt with as if it were the property of the family, while in all other rspects it is treated as the absolute

property of the holder for the time being. This is brought out in Section 587 at page 600 of *Mulla's Hindu Law* (7th Edition) which I quote below :—

"587. *Impartible property whether coparcenary property.* In considering whether an ancestral impartible estate is coparcenary property or not, a distinction should be drawn between present rights, that is, the right to demand a partition and the right to joint enjoyment, and future rights. In the case of an *impartible* estate the right to *partition* and the right of joint enjoyment are from the very nature of the property incapable of existence, and there is no coparcenary to this extent. No coparcener, therefore, can prevent alienations of the estate by the holder for the time being either by gift or by will (section 588), nor is he entitled to maintenance out of the estate (section 589). But as regards future rights, that is, the right to survivorship, the property is to be treated as coparcenary property, so that on the death intestate of the last holder, it will devolve by survivorship according to the rules stated in Section 591 below."

The holder of an impartible estate is entitled to exclusive possession and enjoyment of the estate. His power of management of the revenue of the estate is much wider than that exercised by the manager of an ordinary Hindu undivided family over the income of the family. He is competent to alienate the estate, except when his right to do so is denied by statute, as in the Madras Presidency. Acquisitions out of the savings of an impartible estate do not form part of the estate but must be regarded as "self-acquisitions" of the holder (I.L.R. 59 Calcutta 1399 and I.L.R. 2 Patna 319). It follows that the estate is the holder's individual property so long as he continues to hold it and that the income which he derives from it is his own and not that of a Hindu undivided family. This is the opinion of the Privy Council, as appears from the following passage of the Judgment quoted above (2 Patna 319) :

"The income when received is the absolute property of the owner of the impartible estate. It differs in no way from property that he might have gained by his own effort, or that had come to him in circumstances entirely dissociated from the ownership of the Raj."

I draw the above conclusions from pronouncements of the Privy Council in cases relating not to income-tax assessment but succession ; but I submit that they fully bear out the finding of the Patna High Court, directly relevant to the present case,

which was given in Miscellaneous Case No. 73 of 1923 (*In re Raja Jyoti Prasad Singh Deo of Panchkote*), reproduced at page 388 of Vol. 1 of Srinivasan's Reports of Income-tax Cases.

8. For these reasons, in my opinion, the income derived from the impartible estate should be assessed as that of an individual. The question should be answered accordingly.

JUDGMENT.

The question before us is:

"Whether in respect of the following three sums, *viz.*, Rs. 8,436 being income assessable under the head 'property', Rs. 998 under 'business' and Rs. 3,755 under other sources (quarries and fisheries) the petitioner was rightly taxed as an individual or whether he should have been taxed as the representative of a Hindu undivided family."

The assessee, the Raja of Bobbili is the present holder of the impartible estate of Bobbili. During the previous year (1st April 1934 to 31st March 1935) he was also the Chief Minister to the Government of Madras. He is besides, the managing member of a Hindu undivided family of which he and his brother are the senior coparceners. For the assessment year 1935-36 his total income from all sources liable to income-tax was ascertained to be Rs. 64,083 made up of the following items:

1. Salaries	Rs. 49,399
2. Interest on Securities.	420
3. Property.	8,446
4. Business: money-lending (Rs. 998) and Kerosine oil Agency (Rs. 525)	1,523
5. Other sources: Dividends (Rs. 540) and quarries and fisheries (Rs. 3,755)	4,295
	Rs. 64,083

He was assessed both to income-tax and super-tax, super-tax being levied as on an individual. With the exception of certain amounts it was admitted that the Raja was rightly assessed as an individual. The sums about which there is a dispute are Rs. 8,436 from property, Rs. 998 from money lending business and Rs. 3,755 from other sources (fisheries and quarries). These sums are income derived from the impartible estate. The assessee's contention is that they are income of the joint family and therefore the joint family should have been assessed as such in respect of them and not the Raja as an individual.

The point for consideration is whether for purposes of income-tax the income from the impartible estate is income of the joint family of which the Raja is the manager; and in this connection certain principles with regard to impartible estates must be stated: and they are that from the very nature of the estate there can be no right of partition and that except in Madras no coparcener can restrain alienations by the head of the family though the right to maintenance and of survivorship may exist. The distinction between an impartible estate and a joint family estate has now been made clear in a number of decisions. What has now to be considered is the income from such an estate, the Income Tax Commissioner's claim being that this income must be regarded for the purposes of income-tax as the income of an individual and in support of his claim a number of cases have been cited. Amongst those cases which in our opinion lend considerable support to the Income Tax Commissioner's contention is *Shibaprasad Singh* v. *Prayag Kumari Debee* (I.L.R. 59 Cal. 1399) a decision of the Privy Council. The litigation in that case related to the succession to the estate of one Raja Durga Prasad who died childless survived by three widows who were the plaintiffs in the suit and the respondents in the first appeal. The defendant Shibaprasad Singh was a collateral relative of the deceased Raja. The parties were governed by the *Mitakshara Law*. The chief item of property was the impartible estate but the Raja died possessed of considerable other immoveable property, also of cash, deposits in banks, jewellery and other moveable property. Upon the Raja's death the defendant took possession of the impartible estate and also other property of the Raja claiming that it passed to him by survivorship. The plaintiffs alleged that the family had ceased to be joint, and claimed the estate under Hindu Law, claiming the other immoveable and moveable property as self-acquisitions. Among the questions of law dealt with was whether the holder of an impartible estate can incorporate with it property either moveable or immoveable so as to make the property descend according to the law of primogeniture governing the estate. It was held that the blending of income from self-acquired property with income from an impartible estate raises no presumption of an intention to incorporate but that intention can be indicated in other modes and that moveable property cannot form an accretion to an ancestral impartible estate and even the income of an estate of that nature is not an accretion to it. In the course of the judgment of their Lordships' Board a large number of cases touching

the question are referred to and examined; and in drawing a distinction between an impartible estate and the ordinary joint family estate on page 1413 it is stated:

"Impartibility is essentially a creature of custom. In the case of ordinary joint family property, the members of the family have (1) the right of partition (2) the right to restrain alienations by the head of the family except for necessity (3) the right of maintenance and (4) the right of survivorship. The first of these rights cannot exist in the case of an impartible estate, though ancestral, from the very nature of the estate. The second is incompatible with the custom of impartibility as laid down in *Sartaj Kuari's case* (I.L.R. 10 All. 272) and the *First Pittapur case* (I.L.R. 22 Mad. 283) and so also the third as held in the *Second Pittapur case* (I.L.R. 47 Mad. 778.) To this extent the general law of the *Mitakshara* has been superseded by custom, and the impartible estate, though ancestral, is clothed with the incidents of self-acquired and separate property. But the right of survivorship is not inconsistent with the custom of impartibility. This right therefore still remains, and this is what was held in *Baijnath's case* (I.L.R. 43 All. 228). To this extent the estate still retains its character of joint family property, and its devolution is governed by the general *Mitakshara* law applicable to such property."

The important words affecting the question here are those which state that "the impartible estate, though ancestral, is clothed with the incidents of self-acquired and separate property". After dealing with the question of whether the family had ceased to be joint their Lordships consider on page 1414, the second question namely whether it is competent to the holder of an ancestral impartible estate to incorporate with the estate other properties belonging to him, and a number of decisions are referred to, the first of them being *Parbati Kumari Debi* v. *Jagadis Chunder Debal* (I.L.R. 29 Cal. 433) which was a case relating to succession to an ancestral impartible estate where some property had been purchased on behalf of the last holder out of the savings of the estate. It was contended that this property had been incorporated with the estate and therefore passed with it. The evidence was that the rents of the estate were collected by the same servant and the collection papers were kept with the papers of the estate and it was held that these facts were not adequate for holding that the Raja intended to incorporate the property with the ancestral estate for the purposes of his succession and that the property must therefore follow the rule of *Mitakshara* as to

self-acquired property. Next *Janaki Prasad Singh* v. *Dwaraka Prasad Singh* (I.L.R. 35 All. 391) is cited. That also relates to immoveable property and referring to the previously cited case, it was held that the question whether properties acquired by an owner become part of the ancesteral estate for the purpose of his succession depends on his intention to incorporate the acquisitions with the original estate. Another case referred to is *Jagadamba Kumari* v. *Wazir Narain Singh* (I.L.R. 2 Patna 319) which was a case relied upon by Mr. Patanjali Sastri in support of his argument and to which a further reference will be made in this judgment. The actual point of the decision in that case was that where the estate is impartible no such presumption as to an intention to incorporate can be drawn from the blending of the income of self-acquired property with the income of the estate as in the case of ordinary joint family estate. The case does not decide that, if the estate is impartible, there can be no incorporation at all. On the contrary, there is an implication, and that too a strong one, that there can be an incorporation at least as regards immoveable property. Several other cases are also referred to. On page 1418 the distinction between the blending of income in the case of a member of a joint family and a member of it who is the holder of an ancestral impartible estate is stated as follows:

"If a member of a joint family blends the income of his self-acquired with which the income of the joint family property, it raises a presumption of an intention to incorporate the self-acquired property with the joint family property: *Rajani Kanta Pal* v. *Jagan Mohan Pal* (I.L.R. 50 Cal. 439). But no such presumption can arise if a member of a joint family, who is the holder of an ancestral impartible estate mixes the income of his self-acquired property with the income of the estate."

Having dealt with the question of the incorporation of immoveable property purchased out of the income of an impartible estate and having held that it can form an accretion to the joint family estate provided the intention on the part of the holder of the impartible estate, is clearly proved, their Lordships proceed to deal on page 1422, with moveable property as distinguished from immoveable property and there say: "None of these considerations, however, apply to moveable property. Such property, their Lordships think, cannot form an accretion to an ancestral impartible estate."

And here follow the very important words:

"The income even of such an estate is not an accretion to the

estate. As was said by the Board in *Jagadamba Kumari* v. *Wazir Narain Singh* (I.L.R. 2 Pat. 319) "the income when received is the absolute property of the owner of the impartible estate." It does not attach to the estate as does the income of an ordinary ancestral estate attach to that estate. The conclusion to which their Lordships have come on this part of the case is that while immoveable property can be incorporated with an impartible estate moveable property cannot."

It will be convenient now to examine the case reported in (I.L.R. 2 Pat. 319), namely, *Rani Jagadamba Kumari* v. *Wazir Narain Singh*, another decision of the Privy Council. There it was held that the income of an impartible joint estate is not so affected by its source that it should be assumed to form an accretion to the estate and further as the holder is entitled to the whole of the income, the principle applicable to an ordinary joint family that self-acquired moneys are to be regarded as joint family property if mixed with the moneys of the joint family, does not necessarily apply to property acquired by the holder of an impartible estate out of the income.

In that case, the deceased holder of an impartible estate had applied savings out of the income to purchasing immoveable properties and making loans, the rents and interest being received by the manager of the estate and treated in his books as part of the income of the estate and it was held that the property so acquired had not become part of the impartible estate but remained the separate property of the deceased holder. One question raised, namely, whether moveable property can ever be treated as an accretion to immoveable property, about which their Lordships expressed considerable doubt has since been set at rest by the decision of their Lordships in *Shibaprasad Singh* v. *Prayag Kumari Debee* (I.L.R. 59 Cal. 1399) already referred to.

LORD BUCKMASTER in delivering the judgment of their Lordships' Board on page 325 states as follows:

"Originally the estate was in debt, and as there is no evidence of any acquisition of property from other sources, it follows that all the estate possessed by the Raja, other than the impartible *raj*, was derived from the income of the *raj* itself."

In the end this income produced very considerable property. There were certain villages, certain mortgages, usufructuary and otherwise, sums due on bonds and decrees, Government Promissory notes to the extent of two lakhs, and other moveable and immoveable properties. With the exception of the Government

Promissory notes the whole of these have been awarded to the plaintiff upon the ground that they represented an accretion to the estate and descended with it. Their Lordships think that this conclusion is wrong and that its error is due to the idea that the produce of the impartible estate naturally belongs to and forms an accretion to the original property. In fact when the true position is considered there is no accretion at all. The income when received is the absolute property of the owner of the impartible estate. It differs in no way from property that he might have gained by his own effort or that had come to him in circumstances entirely dissociated from the ownership of the *raj*. It is a strong assumption to make that the income of property of this nature is so affected by the source from which it came that it still retains its original character.

It is possible that this confusion is due to the consideration of the position with regard to an ordinary joint family estate. In such a case, the income, equally with the corpus, forms part of the family property, and if the owner mixes his own moneys with the moneys of the family as for example by putting the whole into one account at the Bank, or by treating them in his accounts as indistinguishable his own earnings share with the property with which they are mingled, the character of joint family property; but no such considerations necessarily apply, to the income from impartible property."

These two cases and *Parbati Kumari Debi* v. *Jigdes Chandar Debal* (29 Cal. 433) are the only three Privy Council decisions where this question of income from impartible estate has been considered. It appears clearly from these decisions that such income is in no repect different from the income derived from the personal exertions of the holder of the impartible estate or his other self acquisition and this income comes to him because he is the holder of the impartible estate. Why should this income be treated for the purposes of income-tax differently to his income arising from his salary as a Minister in respect of which he is assessed under Sec. 3 as an individual. In addition to these three Privy Council decisions, there is a decision of the Patna High Court which is directly in point, viz., *Sri Sri Raja Siva Prasad Singh* v. *The Crown* (4 Pat. 73). There it was held that the Finance Act of 1922, which for the purpose of assessing super tax allows a larger deduction from income in the case of a Hindu joint family than in the case of an individual, contemplates that that larger deduction shall be made only in a case of the income of an undivided family in

which all the coparceners are interested, and not in the case of an impartible estate where the income is the sole property of the holder for the time being. On page 88 DAWSON MILLER, C.J., says :—

"The income of the estate is that of the incumbent for the time being, nor does the fact that he is bound to maintain his sons entitle him to treat the income as that of the undivided family. It is essentially his income and I so hold. The Finance Act contemplates the larger deduction for purposes of supertax only in a case where the income is that of an undivided family in which they are all jointly interested and not in the case of an impartible estate where the income is the sole property of the holder for the time being."

The latest decision of the Privy Council in *Collector of Gorakhpur* v. *Ram Sundar Mal* (56 All. 468) does not touch this question and what was decided there was that the right of the junior members of the family to maintenance out of an ancestral impartible estate is based upon their joint ownership and not custom. It does not say that the income of an impartible estate is not the income of the holder for the time being or that the latter is bound in law to apply the income or any portion thereof towards maintenance of the junior members. The contention of the assessee that this income falls to be assessed as that of a Hindu undivided family is founded upon the words of S. 14 of the Income Tax Act which reads as follows:

"The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family."

The object of this exemption is to save double taxation and therefore where the Hindu undivided family has been assessed under S. 3 in respect of its income a member of it is not to be assessed again individually. It is argued that the assessee here who is admittedly a member of a Hindu undivided family, has received the income in question as such member, that he is therefore exempt from an individual assessment and that the words of the section themselves therefore negative the income-tax authorities' contention and further assistance is sought by reference to decisions both of this High Court and other High Courts. Taking this High Court first, there is *Commissioner of Income Tax* v. *Zamindar of Chemudu* (57 Mad. 1053) where it was held that a sum received as maintenance by an assessee as the brother of the last holer of an ancestral impartible estate entitled under the law to receive maintenance out of such estate is a sum received by him as a member of a Hindu undivided family, within the meaning of

Cl. (1) of Sec. 14 of the Indian Income-tax Act and that the right to maintenance which the son of a zamindar still possesses is not the creature of custom but it is an incident to the ordinary joint family property which has been left untouched by custom despite its encroachment on the other incident, *i.e.*, he receives the maintenance by reason of his status. As Ramesam, J., who delivered the judgment of the Full Bench on page 1027 says :—

" The question is whether the assessee received his payment as a member of a Hindu undivided family. Undoubtedly he does receive this payment of Rs. 6,000 because he is a member of the undivided Hindu family."

It is different in the case of the assessee here. It is true that he is a member of a Hindu undivided family but he receives nothing from the family. The income is received by him as the holder of the impartible estate and it cannot be said that he receives it as a member of a Hindu undivided family. The income is his and the junior members have no right therein. *Kishen Kishore* v. *Commissioner of Income-tax* (14 Lah. 225), was also cited for the assessee. What was decided in that case was that there is no legal sanction for the proposition that an estate which is governed by the rule of primogeniture cannot belong to an undivided Hindu family but must be the sole property of the person who has succeeded to it by the rule of primogeniture. This decision however, does not touch the question in point here. It is not disputed that the corpus belongs to the undivided family. The question is as regards the income; and if in this case it is assumed that the income from an impartible estate means the joint family income, then that is clearly contrary to what was decided in *Jagadamba Kumari* v. *Wazir Narain Singh*, *Parbati Kumari Debi* v. *Jagadis Chunder Debal* and *Shibeprasad Singh* v. *Prayagkumari Debee* and to none of these cases is any reference made; and we must repectfully dissent from that view. In *Commissioner of Income-tax, Bihar and Orissa* v. *Maharaja Visheswar Singh* (14 Pat. 785) it was held that Sec. 14 (1) of the Income Tax Act applies only to sums received by a member of a Hindu undivided family out of income to a share in which he has a vested right, that is to say, sums which he receives from the joint income of the family and that a sum received by an assessee because he is a member of an undivided family does not stand on the same footing as a sum received by him as a member of the family within the meaning of Sec. 14 (1) of the Act. It is contended that this case assists the

assessee because it shows that the income is still the joint income of the family. But the assertion of the assessee that the allowance was paid out of joint family property was not controverted in that case and as stated in the leading judgment the court had not to consider the nature of the income from the impartible estate in the hands of the holder. In our view, the junior member receives maintenance because he is entitled to a share in the corpus and the holder of the impartible estate is bound to maintain the junior members of the family and no useful purpose will be served by a reference to other cases as none of the cases cited on behalf of the assessee, in our opinion, destroy the force of those relied upon by the Commissioner of Income Tax. We hold therefore, that the assessee was rightly assessed in respect of his income as an individual. The question propounded is answered accordingly. The assessee will pay Rs. 250 costs to the Commissioner of Income Tax.

Reference answered.

[IN THE PRIVY COUNCIL.]

KALYANJI VITHALDAS and others

v.

COMMISSIONER OF INCOME TAX, BENGAL.

LORD ALNESS, SIR SHADI LAL and SIR GEORGE RANKIN.

November 30, 1936.

HINDU UNDIVIDED FAMILY—INCOME FROM SEPARATE PROPERTY OF HINDU HAVING UNDIVIDED SONS—INCOME FROM ANCESTRAL PROPERTY OF HINDU HAVING NO SONS BUT ONLY WIFE AND DAUGHTERS—WHETHER ASSESSABLE AS INCOME OF INDIVIDUAL OR OF HINDU UNDIVIDED FAMILY—'HINDU UNDIVIDED FAMILY' MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 3, 55.

Income from separate and self acquired property of a Hindu which has not been thrown into the common stock, is assessable to super-tax as the income of an individual and not as the income of a Hindu undivided family, even though he has sons from whom he is not divided inasmuch as the sons have no interest in such income.

The existence of a wife or of a wife and daughters does not make income derived from the ancestral property of a Hindu, income of a Hindu undivided family for purposes of assessment to super-tax.

The expression 'Hindu undivided family' is used in the Indian Income Tax Act with reference not to one school only of Hindu law, but to all schools, and it is a mistake to read it as equivalent to the narrower expression Hindu coparcenary. It cannot be said that no female can be a member of a joint Hindu family.

Though the words 'income of' are capable of a wider or narrower meaning, under Secs. 3 and 55 of the Income Tax Act, income is not to be attributed to any one of the five classes of persons mentioned, by any loose or extended interpretation of the words, but only where the application of the words is warranted bg their ordinary legal meaning.

Though in an extra legal sense and even for purposes of legal theory ancestral property may be described as family property, it does not follow that in the eye of the Hindu law it belongs, save in certain circumstances, to the family as distinct from the individual.

Though by reason of its origin a man's property may be liable to be divested wholly or in part on the happening of a particular event or may be answerable for particular obligations or may pass at his death in a particular way, if his personal law regards him as the owner, the property as his property and the income therefrom as his income it is chargeable to income tax as his, i.e., *as the income of an individual.*

The judgment of the Calcutta High Court in MOOLJI SICKA AND OTHERS, *In re* (1935 I.T.R. 123) *affirmed.*

Cases referred to :

KISHEN KISHORE'S CASE [1932] (I. L. R. 14 Lah. 255 ; 1933 I. T. R. 143).

LAL RAM SINGH *v.* DEPUTY COMMISSIONER [1923] (50 I.A. 285).

LAXMINARAYAN'S CASE [1935] (I. L. R. 59 Bom. 618 ; 1935 I. T. R. 367).

RAJA BHUNESH PRATAP NARAIN SINGH'S CASE [1932] (6 I.T.C. 175).

SHIVA PRASAD SINGH *v.* SECRETARY OF STATE [1924] (1 I. T. C. 384).

VEDATHANNI'S CASE [1932] (I. L. R. 56 Mad. 1 ; 1933 I. T. R. 70).

Appeals from the judgment of the Calcutta High Court in the case of *Moolji Sicka & Others, In re,* reported in 1935 Income Tax Reports at p. 123 [P. C. Appeals Nos. 24-29 of 1936].

For the facts of the case, the Commissioner's Reference and the judgment of the Calcutta High Court, reference may be made to 1935 I. T. R. page 123 *et seq.*

Leslie De Gruyther, K.C. and *L.P.E. Pugh*, for the Appellants.
A. M. Dunne, K.C., and *E.L. Norton*, for the Commissioner of Income Tax.

JUDGMENT.

SIR GEORGE RANKIN.—These six appeals concern the assessment to super-tax for the year 1931-32 of six of the seven partners of a firm known as Moolji Sicka & Co. This firm was for the year in question registered under Sec. 26-A of the Income tax Act, the instrument of partnership being a Gujarati deed dated 11th September 1930. Its business was that of dealers in Indian tobacco and cigarettes. The assessment to income tax of the registered firm has been made in due course, and the present controversy is whether six of the partners should each be assessed to super-tax upon his share of the profits as an individual, or whether these six shares should each be assessed as income of a Hindu undivided family. The rates of super-tax imposed by the relevant Finance Act are less in the case of a Hindu undivided family than in the case of an individual.

The problem has to be answered by applying to the facts of each case the language of Sec. 55 of the Act:

" In addition to the income tax charged for any year there shall be charged, levied and paid for that year in respect of the total income of the previous year of any individual, Hindu undivided family, company, unregistered firm or other association of individuals, not being a registered firm, an additional duty of income-tax (in this Act referred to as super-tax) at the rate or rates laid down for that year by Act of the Indian Legislature.

Provided that, where the profits and gains of an unregistered firm have been assessed to super-tax, super-tax shall not be payable by an individual having a share in the firm in respect of the amount of such profits and gains which is proportionate to his share."

The two questions finally referred in each case by the Commissioner for the opinion of the High Court at Calcutta are as follows:

' (1) Whether the family of the assessee, as it now stands, is a Hindu undivided family within the meaning of the Income tax Act?

(2) If the first question be answered in the affirmative, whether in the circumstances recorded in the case the income in question should be treated as income of that family and assessed as such?"

The High Court (Lort-Williams and Jack, JJ.) have in each case answered the first question in the negative and held that the second question did not arise.

The parties are governed by the Mitakshara and their pedigrees and families may be exhibited as under :

I
SICKA

Moolji

By first wife: Kanji, wife, daughter. Sewdas, wife

By second wife: Mohan Das.

Purshottam (d. 1933)
(wife)
Odhavji (son)
daughter.

II
VITHALDAS

Kalyanji (wife 3 sons, daughter).

Chaturbhuj (wife, daughters).

Champsi

The history of the firm according to the Commissioner is that in or about 1912 the business was begun by Moolji and Purshottam (brothers who had separated) and Kalyanji (who is not related to either) and that in no case were ancestral funds employed for the purpose. That in 1919 Moolji made gifts of capital to each of his sons by his first wife namely, Kanji and Sewdas. That at least since 1919 Moolji, Kanji and Sewdas have been separate from each other. That in 1919 on the terms of a Gujarati deed dated 1st May, Kanji (son of Moolji) and Chaturbhuj (brother of Kalyanji) were taken into the partnership. That in 1930 Sewdas and Kalyanji's brother Champsi were taken into the firm on the terms of the deed of 11th September, 1930, already mentioned. That the interest of Kanji and of Sewdas was a gift from their father Moolji, and that of Chaturbhuj a gift from his brother Kalyanji. That in no case has it been proved that the individual partner has thrown his interest in the firm or his receipts therefrom into the common stock, i.e., treated it as joint family property. Their Lordships are of opinion that the High Court was

right in proceeding upon these findings of fact by the Commissioner.

From these facts it clearly appears, so far as Moolji, Purshottam and Kalyanji are concerned, that they are each members of a Hindu undivided family. Each has a son or sons from whom so far as the evidence goes he is not divided. But the income from the firm is clearly the separate and self-acquired property of the partner, and as it has not been thrown into the common stock it cannot be regarded as income of the family. It is the income of an individual and assessable to super-tax as such under Sec. 55 of the Act. In these three cases, therefore, the High Court should have answered the first question in the affirmative and the second question in the negative.

The interest of Chaturbhuj in the firm was obtained from his brother Kalyanji. It is self-acquired and not ancestral property. Chaturbhuj has no son, but even if he had, the son would have taken by birth no interest in the income now in question. The High Court might well have answered the second question in the negative and said of the first question that it did not arise.

In none of the four cases above-mentioned, *viz.*, those of Moolji, Purshottam, Kalyanji and Chaturbhuj does the fact that the man has a wife and daughter (or more than one) affect the result. The existence of a son does not make his father's self-acquired property family property or joint property. That the existence of a wife or daughter does so is untenable.

There remain the cases of Kanji and Sewdas. Neither has a son but, in the case of each, his interest in the firm was obtained by gift from his father Moolji. Without deciding the question which was left open in *Lal Ram Singh* v. *Deputy Commissioner* (50 I.A. 265), their Lordships, for the purposes of the present case, will assume that their interest was ancestral property, so that if either had a son, the son would have taken an interest therein by birth. But no son having been born, no such interest has arisen to qualify or diminish the interest given by Moolji to Kanji and to Sewdas. Does then the existence of a wife, or of a wife and a daughter, make it income of a Hindu undivided family rather than income of the individual partner? Their Lordships think not. A man's wife and daughter are entitled to be maintained by him out of his separate property as well as out of property in which he has a coparcenary interest, but the mere existence of a wife or daughter does not make ancestral property joint. "Interest" is a word of wide and vague significance, and no doubt

it might be used of a wife's or daughter's right to be maintained, which right accrues in the daughter's case on birth; but if the father's obligations are increased, his ownership is not divested, divided or impaired by marriage or the birth of a daughter. This is equally true of ancestral property belonging to himself alone as of self-acquired property. The cases of Kanji and of Sewdas can be disposed of by answering the second question in the negative.

The High Court approached the cases by considering first whether the assessee's family was a Hindu undivided family, and in the end left unanswered the question whether the income under assessment was the income of that family. This is due no doubt to the way in which the Commissioner had stated the questions. But, after all if the relevant Hindu law *had* been that the income belonged, not to the assessee himself, but to the assessee, his wife and daughter jointly, it is difficult to see how that association of individuals could have been refused the description "Hindu joint family". The phrase "Hindu undivided family" is used in the statute with reference, not to one school only of Hindu law, but to all schools; and their Lordships think it a mistake in method to begin by pasting over the wider phrase of the Act the words "Hindu co-parcenary", all the more that it is not possible to say on the face of the Act that no female can be a member. The Bombay High Court, on the other hand, in *Laxminarayan's case* having held that the assessee, his wife and mother were a Hindu undivided family, arrived too readily at the conclusion that the income was the income of the family.

The phrase which has to be considered and applied to the facts is "the total income of the previous year of any individual, Hindu undivided family, company, unregistered firm or other association of individuals not being a registered firm". The words "income of" are simple words and are capable of wider or narrower meaning; but for the present purpose the Courts are concerned with them as they appear in an Income-tax Act; and under Sec. 3 or Sec. 55 income is not to be attributed to any one of the five classes of persons mentioned by any loose or extended interpretation of the words, but only where the application of the words is warranted by their ordinary legal meaning. The relevant meaning in the present case is the ordinary meaning in Hindu Law according to the Benares school. In an extra legal sense and even for some purposes of legal theory, ancestral property may perhaps be described, and usually, described, as family property; but it does not follow that in the eye of the Hindu law it belongs

save in certain circumstances, to the family as distinct from the individual. By reason of its origin a man's property may be liable to be divested wholly or in part on the happening of a particular event, or may be answerable for particular obligations, or may pass at his death in a particular way; but if, in spite of all such facts, his personal law regards him as the owner, the property as his property and the income therefrom as his income, it is chargeable to income-tax as his, *i.e.*, as the income of an individual. In their Lordships' view it would not be in consonance with ordinary notions or with a correct interpretation of the law of the Mitakshara, to hold that property which a man has obtained from his father belongs to a Hindu undivided family by reason of his having a wife and daughters.

The result is that in the cases of Moolji, Purshottam and Kalyanji the first question stated by the Commissioner should be answered Yes and the second No. In the other cases the second question should be answered No and the first question need not be answered.

Upon the reported decisions cited during argument their Lordships will only observe that the decision in *Vedathanni's case* does not cover the present question which arises under Sec. 55 of the Act, and that they take no exception to the result arrived at in the case of *Raja Bhunesh Pratap Narain Singh* though they do not agree that a Hindu joint family necessarily consists of male members only. Their Lordships will not here deal with the case of an impartible estate held by the son or of several male members of a family, as to which there have been conflicting decisions in India [cf. *Raja Siva Prasad Singh* v. *Secretary of State* and *Kishen Kishore* v. *Commissioner of Income-tax, Punjab*].

They will humbly advise His Majesty that the appeals should be dismissed with costs.

Appeals dismissed.

[IN THE MADRAS HIGH COURT.]

S. A. S. S. CHELLAPPA CHETTIAR
v.
COMMISSIONER OF INCOME TAX, MADRAS.

SIR H. O. C. BEASLEY, C. J., MOCKETT, J., AND LAKSHMANA RAO, J.

January 15, 1937.

INCOME-TAX—ALLOWANCES—INTEREST ON BORROWED CAPITAL—MONEY-LENDING BUSINESS—ASSESSEE COMPELLED TO ACCEPT AGRICULTURAL LANDS IN REPAYMENT OF LOAN—INTEREST ON CAPITAL BORROWED REPRESENTING AGRICULTURAL LANDS SO RECEIVED—ESTABLISHMENT AND OTHER CHARGES FOR MANAGEMENT AND CULTIVATION, WHETHER ALLOWABLE—INDIAN INCOME TAX ACT (XI OF 1922), Sec. 10 (2) (iii).

Where a person who is carrying on business as a money-lender borrows money for his money-lending business and lends it out to constituents, and is obliged in the course of business to receive agricultural lands in repayment of his debts from such constituents, he is entitled to a deduction of the interest paid by him also on so much of the capital borrowed by him for business purposes as is represented by the agricultural lands got in, under Section 10 (2) (iii), in computing the profits and gains of his money-lending business.

He is also entitled to a deduction in respect of the establishment and other charges incurred by him for managing and cultivating such lands and the amount spent for obtaining conveyances of such lands.

SOMASUNDARAM CHETTIAR v. COMMISSIONER OF INCOME TAX, MADRAS [1932] 55 Mad. 885 and PROVIDENT INVESTMENT CO., LTD. v. COMMISSIONER OF INCOME TAX, BOMBAY [1932] (6 I.T.C. 21) distinguished.

HUGHES v. BANK OF NEW ZEALAND [1936] (1936 All Eng. L. R. 975) relied on.

Cases referred to:

CHETTIAPPA CHETTIAR v. COMMISSIONER OF INCOME TAX, [1930] (4 I.T.C. 188; 122 I.C. 349; 31 M.L.W. 215; A.I.R. 1930 Mad. 119).

COMMISSIONER OF INCOME-TAX, BIHAR AND ORISSA *v.* MAHARAJADIRAJ OF DARBHANGA [1935] (I.L.R. 14 Pat. 623; 62 I.A. 215; 1935 I.T.R. 305; 157 I.C. 289).

HUGHES (INSPECTOR OF TAXES) *v.* BANK OF NEW ZEALAND [1936] (3 All England Law Reports 975).

LAKSHMANAN CHETTIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS [1930] (4 I.T.C. 200; A.I.R. 1930 Mad. 121; 58 M.L.J. 68).

MAXSE'S CASE [1919] (1 K.B. 647; 88 L.J.K.B. 752; 119 L.T. 371; 34 T.L.R. 541).

PROVIDENT INVESTMENT CO., LTD. *v.* COMMISSIONER OF INCOME TAX, BOMBAY [1932] (6 I.T.C. 21; 1932 Comp. Cas. 312; 33 Bom. L.R. 1587; 135 I.C. 810).

RANSOM'S CASE [1918] (2 K.B. 709; 88 L.J.K.B. 342; 119 L.T. 369).

SACHINDRA MOHAN GHOSE *v.* COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA [1932] (5 I.T.C. 397; I.L.R. 11 Pat. 47; 136 I.C. 63).

SOMASUNDARAM CHETTIAR *v.* COMMISSIONER OF INCOME TAX, [1932] (2 I.T.C. 505; I.L.R. 55 Mad. 885; 138 I.C. 301; 63 M.L.J. 22).

Case stated by the Commissioner of Income-tax, Madras, under Section 66 (3) of the Indian Income-tax Act, Act XI of 1922, in the matter of the assessment of S.A.S.S. Chellappa Chettiar for the year 1934-35. [O.P. No. 252 of 1935].

T. R. Venkatarama Sastri and *K. S. Sankara Iyer*, for the assessee.

M. Patanjali Sastri, for the Commissioner.

STATEMENT OF CASE.

In accordance with the High Court's order quoted above I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Section 66 (3) of the Indian Income-tax Act (XI of 1922) hereinafter referred to as the Act.

FACTS

2. The petitioner is the manager of a Hindu undivided family deriving income from property, business (money-lending) at Kothamangalam (his headquarters) within the jurisdiction of the Income-tax Officer, Karaikudi II Circle, at Kyaiklat and Thayetmyo in Burma, and at Klang, Malacca and Kualalumpur in the Federated Malay States. He also derives income from agricultural lands.

3. For the assessment of the year 1934-35 (previous year Tamil year Srimukha corresponding to 13-4-1933 to 12-4-1934) the petitioner was assessed on a total income computed at Rs. 30,963. In computing the income as above, the Income-tax Officer disallowed (i) Rs. 17,796 under interest payments in the Kyaiklat branch and (ii) Rs. 3,114 under establishment and other charges in the Kyaiklat and Thayetmyo branches.

(i) Interest disallowed in the Kyaiklat branch—Rs. 17,796.

The petitioner owns lands used for agricultural purposes and assessed to land revenue in Burma. These lands were acquired in repayment of money lent in the course of the money-lending business carried on at Kyaiklat. He now cultivates them and derives income from them. The amount invested in these lands, the expenses incurred in cultivating them and the receipts from them are incorporated in the accounts of the money-lending business. The business is conducted mainly with borrowed capital. According to the Balance Sheet as on the last day of the year of account the total amount borrowed is Rs. 5,82,897, while the petitioner's own capital is Rs. 37,036 and the total amount invested in lands is Rs. 4,52,192. Thus roughly 4/5 of the borrowed amount has been used for purchasing the lands. The total interest on the borrowed money paid during the year of account amounted to Rs. 22,245 and the receipts from the lands amounted to Rs. 11,567. In determining the profits liable to assessment the petitioner excluded the receipts, *viz.*, Rs. 11,567 from his income on the ground that it was "agricultural income" exempt from assessment under Section 4 (3) (viii) of the Act, but claimed the entire interest paid, *viz.*, Rs. 22,245. A copy of the Profit and Loss account filed by the petitioner along with his return of income is filed marked Exhibit A. The Income Tax Officer held that since 4/5 of the borrowed money had been invested in lands the income from which (Rs. 11,567 in the year of account) was exempt from assessment, the interest paid on the borrowed money to the extent to which it had been used for purchasing lands was not deductible from the profits of the money lending business liable to assessment. He accordingly disallowed 4/5 of Rs. 22,245 or Rs. 17,796. These figures are not disputed.

(ii) Establishment and other charges disallowed—Rs. 3,114.

This is made up of the following items :

(a) Establishment charges	Rs. 2,298

(b) Loss in cattle purchase, lands and bulls accounts.	Rs.	779
(c) Conveyance charges relating to lands	Rs.	37
	Rs.	3,114

The staff employed by the petitioner at Kyaiklat attended both to the management of the lands and to the money lending business. But the expenses on account of establishment charges were all debited to one account. The total expenditure under this head claimed by the petitioner was Rs. 5,490. Of this Rs. 893 was salary payable prior to the year of account. Deducting this, the salary of the year amounted to Rs. 4,597. As in the case of the interest on borrowed capital, the Income-tax Officer held that the whole of this expenditure should not be charged against the profits of the money-lending business, as it was incurred not only for earning those profits but also for earning the profits of the income from lands exempt from assessment. In the absence of separate accounts to show the agricultural portion of the expenditure the Income-tax Officer fixed it at 50% of the total with reference to the volume of work involved in each case.

He accordingly disallowed half of Rs. 4,597 or Rs. 2,298. The other items amounting to Rs. 816 were expenses solely incurred in connection with the cultivation or acquisition of the lands. The Income-tax Officer therefore disallowed them also.

An extract from the Income-tax Officer's order is filed marked Exhibit B.

4. The petitioner appealed to the Assistant Commissioner and among other things objected to the disallowance of the above two items. The Assistant Commissioner confirmed the Income-tax Officer's findings in respect of these two items but on other grounds he reduced the assessment from Rs. 30,963 to Rs. 25,605. An extract from his order is filed marked Exhibit C.

5. The petitioner then appealed to me for a reference to the High Court on two alleged questions of law. My predecessor held that the questions formulated by the petitioner did not arise and accordingly dismissed the application. But under Section 33, he allowed Rs. 37 (conveyance charges relating to lands—item (ii) (c) in paragraph 3 above) and reduced the assessment accordingly. A copy of his order under Sec. 66 (2) is filed marked Exhibit D.

QUESTION.—The petitioner then moved the High Court under Section 66 (3) and the High Court has now ordered me to refer the following two questions:

(1) Where a person who is carrying on business as a money-lender, borrows money for his money-lending business, lends it out to constituents, and is obliged in the course of the business to receive agricultural lands in repayment of his debts from such constituents, is he not entitled to a deduction of the interest paid by him on so much of the capital borrowed by him for business purposes as is represented by the agricultural lands got in under Section 10 (2) (iii) in computing the profits and gains of the banking business for the year of account?

(2) Whether the petitioner is not entitled to a deduction in respect of the establishment and other charges for managing and cultivating the lands in Kyaiklat and Thayetmyo on the ground that they are expenses incurred for agricultural purposes and the amount spent for obtaining conveyances on the ground that it is an expense of a capital nature.

OPINION OF COMMISSIONER: Question (1). The main point for decision is whether the amount in respect of which interest has been disallowed is "capital borrowed for the purposes of the business" within the meaning of Section 10 (2) (iii) of the Act. It has been held by this Court in *Somasundaram Chettiar* v. *Commissioner of Income Tax* that "business" in this section means the business whose profits are being assessed in the year under consideration and that the expression "capital borrowed for the purposes of the business," means capital borrowed "*and used* for the purposes of the business." The Bombay High Court has also held the same view in *Provident Investment Co.* v. *Commissioner of Income Tax, Bombay*. It is not disputed that the profit from the lands though they have been acquired with the funds borrowed by the money-lending business is not the subject matter of the assessment and in fact such profits have been rightly excluded by the petitioner and the Income tax Officer from the computation of the "total income". The borrowed capital represented by these lands cannot therefore be said to have been used for earning the profits of the money-lending business which are the subject matter of this assessment. The fact that in the year in question the income from the lands was less than the interest on the money used for acquiring them is immaterial. If the price of produce rises or the yield from the land increases the petitioner's income from the lands will certainly

be more than the amount of the interest in question and clearly such income will continue to be exempt from assessment under Section 4 (3) (viii). It is inequitable to allow the petitioner to deduct from his "taxable income" the charges incurred in earning "non-taxable income". The question should be answered in the negative.

Question (2). The question whether the establishment and other charges for managing and cultivating the lands can be deducted in computing the profits of the money-lending business will depend upon whether these charges will fall under the allowances described in Section 10 (2), Clauses (i) to (ix) of the Act. Obviously clauses (i) to (viiia) of this sub-section have no application. The condition laid down for an allowance under clause (ix) is that the expenditure should have been incurred solely for the purpose of earning the profits and gains in respect of which tax is payable by the petitioner under the head 'business'. The expenditure in question is similar to the interest considered under question (1) above and for the reasons given under that question this expenditure cannot be said to have been incurred for the purpose of earning the profits of the money-lending business. I am therefore of the opinion that the petitioner is not entitled to a deduction in respect of these charges. The first part of the question should be answered accordingly.

The amount spent for obtaining conveyances, *viz.*, Rs. 37, was allowed in my predecessor's order under Section 33, (No. 411-35 dated 23rd July 1935). The question whether it is expenditure of a capital nature does not therefore arise on the facts of this case. A similar question has been considered by the Privy Council in *Raja Raghunandan Prasad Singh and another* v. *The Commissioner of Income-tax, Bihar and Orissa.* According to that decision the expenditure in question is of a capital nature. The 2nd part of the question should be answered accordingly."

JUDGMENT.

The assessee is the manager of a Hindu undivided family carrying on money-lending business in India, Burma and the Federated Malay States with borrowed capital. The findings of fact are not very clear but before us the argument has proceeded on the following basis: Owing to certain clients in Burma being unable to meet their obligations, the assessee was compelled to receive in repayment of loans made by him, agricultural lands in Burma. The money which had been lent had originally been

borrowed by the assessee for the purpose of his money-lending business, that is to say, that he borrowed and in his turn lent the same money no doubt at a higher rate of interest. It was conceded by Mr. Patanjali Sastri that the assessee was carrying on one business for the year of assessment 1934-35. It has not been contended before us that the assessee was retaining and cultivating these lands of his own inclination, but owing to the fall in agricultural lands he was involuntarily in possession and was preserving his capital in the only way open to him pending a return of agricultural economic conditions which made it possible for him to realise, if not all, at least some of the capital originally lent to the borrowers, the previous owners of the lands. It was not disputed that the whole of the money borrowed, a great part of which is now in the form of land, was originally borrowed for the purpose of the money-lending business. In view of these admissions of fact, it is not necessary for us to send this matter back to the Commissioner for findings. For the assessment of the year 1934-1935 the assessee was assessed on total income computed at Rs. 30,963. In computing the income the Income-tax Officer disallowed Rs. 17,796 under interest payment in the Kyaiklat branch and Rs. 3,114 under establishment and other charges in the Kyaiklat and Thayetmyo branches. The interest charges disallowed were claimed by the assessee under Section 10 (2) (iii) of the Income-tax Act as representing the capital borrowed by him for the purpose of his business which capital was now represented by agricultural lands. The Income-tax Officer held that four-fifths of the money borrowed was so represented but he disallowed the claim on the ground that as the money was invested in agricultural lands the income from which is exempt from income-tax under Sec. 4 (3) (viii) of the Act the assessee was not entitled to the allowance mentioned in Sec. 10 (2) (iii). He accordingly disallowed the claim for interest as regards four-fifths of the money borrowed which he considered was the amount of the capital then represented by lands but he allowed the remaining one-fifth as being money borrowed for the purpose of the money-lending business and utilised therein. The assessee also claimed a sum of Rs. 3,114 made up as follows:

Establishment charges	Rs. 2,298
Loss in cattle purchase, lands and bulls accounts	779
Conveyance charges relating to lands	37

The last item was allowed by the Commissioner. The other items were claimed as being charges under Sec. 10 (2) (ix). The Commissioner disallowed the amount of these other items also on the ground that as it is expenditure for the purpose of earning agricultural income, it also was not deductible on the same grounds on which he had ruled that money borrowed and subsequently used in agricultural lands was not a permissible deduction. The assessee moved this Court and in compliance with the Court's direction the Commissioner has referred to us the following two questions:

(1) Where a person who is carrying on business as a money-lender borrows money for his money-lending business, lends it out to constituents, and is obliged in the course of the business to receive agricultural lands in repayment of his debts from such constituents, is he not entitled to a deduction of the interest paid by him on so much of the capital borrowed by him for business purposes as is represented by the agricultural lands got in under Sec. 10 (2) (iii) in computing the profits and gains of the banking business for the year of account?

(2) Whether the petitioner is not entitled to a deduction in respect of the establishment and other charges for managing and cultivating the lands in Kyaiklat and Thayetmyo on the ground that they are expenses incurred for agricultural purposes and the amount spent for obtaining conveyances on the ground that it is an expense of a capital nature?

Section 10 (1) and (2) is as follows:

"(1) The tax shall be payable by an assessee under the head "Business" in respect of the profits or gains of any business carried on by him.

(2) Such profits or gains shall be computed after making the following allowances namely:

(iii) in respect of capital borrowed for the purposes of the business, where the payment of interest thereon is not in any way dependent on the earning of profits, the amount of the interest paid."

It is, as we have emphasised, conceded that this capital was borrowed for the purpose of the business and on the facts we hold that it has also been used for the purpose of the business because it is an unquestioned fact that the assessee received these lands in repayment of the loans made by him not of his own volition but of necessity, there being no other method of getting payment, and that therefore these lands came into his possession directly in the

course of his money-lending business and represented the capital originally borrowed. *Prima facie* therefore the assessee is entitled to the benefit of Sec. 10 of the Act, but the Commissioner's learned counsel argues that nothing which cannot help to earn taxable income is the subject of exemption and agricultural income is not taxable and by implication in Sec. 10 (1) and (2) before the words " profits or gains " must be read the word " taxable". He contends that the object of Sec. 10 is to reduce the amount of taxable income and that it cannot therefore possibly apply to any income which is not the subject of taxation. No case exactly in point has been cited. But the Commissioner has relied especially on two Indian decisions, one of this High Court and the other of the Bombay High Court. In *Somasundaram Chettiar* v. *Commissioner of Income-tax, Madras*, the question arose whether interest on capital borrowed in India to be used abroad (in that case the Federated Malay States) was a permissible deduction under Sec. 10 (2) (iii) of the Income Tax Act. It must be emphasised that no complication with regard to the use of the capital in a foreign country arises here, Burma and Madras being subject to the same Act. This High Court took the view that " business " in Sec. 10 (2) (iii) means the business whose profits are being assessed in the year under consideration. In *Provident Investment Company Limited* v. *The Commissioner of Income tax, Bombay*, the Bombay High Court held that where an Indian finance company borrowed money in British India and invested it abroad keeping both the income and capital abroad, the interest on the money so borrowed was not deducted under Sec. 10 (2) (iii) of the Income Tax Act by reason of the fact that the income was not the subject of taxation in British India. The decision of the Court there again rested on the fact that the whole of the interest derived from the borrowed capital was outside the jurisdiction and was not the subject of taxation in India. At page 25 BEAUMONT, C. J., expressed himself as follows :

" Now looking at the section again in the light of the context, tax is to be payable by an assessee under the head of " Business " in respect of the profits or gains of any business carried on by him. Clearly that must mean in respect of the taxable profits or gains of any business carried on by him and the business must be one which earns taxable profits or gains. Then when we come to sub-section (2) (iii) an allowance is to be made in respect of interest on capital borrowed for the purposes of the business. Now, I think that again must be for the purposes of the business which

earns or is capable of earning taxable profits. Whether or not in fact taxable profits are earned is not necessarily the criterion, because the borrowed money may earn no profit, but I think that "business" referred to in that section is a business which is so carried on that taxable profits may be earned, and unless it is a business of that character a deduction for interest on capital money borrowed for the purposes of that business is not allowable under the Act."

It will be noticed in both these cases the income derived from borrowed capital was not the subject of any taxation in British India. In this connection it should be observed that Sec. 4 of the Income Tax Act makes the Act applicable to all income, profits or gains, accruing or arising or received in British India, or deemed to be received therein. But the Act does not apply to agricultural income in British India. Under Sec. 4 (3) (viii) it is provided that "This Act shall not apply to :—agricultural income." "Agricultural income" is defined in Sec. 2 (1) as meaning

"(a) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land revenue in British India or subject to a local rate assessed and collected by officers of Government as such;

(b) any income derived from such land by—(i) agriculture."

The rest of the definition is not relevant. It should be observed that the agricultural income must be derived from "such land", *i.e.*, land assessed to land revenue in British India or subject to a local rate assessed and collected by the officers of Government as such. There is no foundation therefore for the argument which we have heard that agricultural income is exempt from all taxation and it is therefore *prima facie* inequitable that money borrowed and represented by an income which does not pay tax should be subject to any of the benefits of the Act. On the contrary, under the Act such income is expressly excluded from the burden of income tax because it has already paid tax to Government in another form. That such circumstances as we now have to consider were in the contemplation of the legislature when passing this Act we take leave to doubt, but they have arisen and must be dealt with not on general principles but in accordance with the principles relating to the construction of a fiscal statute, *viz.*, that it should be strictly construed.

It seems to us that the governing section in order to decide this matter must be Sec. 10 (2) (iii). Was the capital borrowed for the purpose of the assessee's business? No difficulty arises about

that, for it is conceded that it was so borrowed. It was also unquestionably used for the purpose of the business because it is again conceded that it was lent to the borrowers. Does it continue to be so used? It is in that respect that it is imported again to emphasise that this case has been argued before us on the basis that these lands came into and were retained in the possession of the assessee in payment of a money-lending debt and *ex necessitate.* In this Presidency there is a current of authority to the effect that immoveable property received by a money-lender in repayment of loans is an asset of his money-lending business and that any profit derived from the sale of such lands and also any income from the lands such as rents etc., must be regarded as the profits of such business and taxable as such (See *Chettiappa Chettiar and others* v. *The Commissioner of Income-tax, Madras*, 4 I.T.C. 188). In that case as here the assessee was a money-lender who had secured his advances on rubber estates which he had finally to take over in repayment of his debts and to hold until a favourable opportunity occurred for resale and it was held that any profits from such resale were profits of his money-lending business. (See also *Lakshmanan Chettiar* v. *The Commissioner of Income-tax, Madras* 4 I.T.C. 200). In *Commissioner of Income-tax, Bihar and Orissa* v. *Maharajadiraj of Darbhanga* (14 Pat. 623) the Judicial Committee had before them for consideration the question as to whether income received from an estate taken over by a lender as security for an amount advanced under an usufructuary mortgage, was agricultural income. At page 631 Lord Macmillan in delivering the advice of the Board, after setting out the facts and emphasising that *prima facie* the income of the land was agricultural income, states as follows :—

" In answer to this *prima facie* conclusive ground for excluding the sum in question from the respondent's assessment the appellant concedes that if the respondent were not a money-lender and if the transaction in virtue of which he receives the rents had not been a transaction entered into *in the course of his money-lending business*, he would have been entitled to invoke the statutory exemption of agricultural income; but the appellant submits that the fact that the respondent carried on a money-lending business and receives the rents as the result of a transaction entered into in the course of that business makes all the difference."

It would appear therefore that the Board recognised the position that rents from agricultural lands could be received in virtue

of a money-lending transaction. Their Lordships then proceed to hold that agricultural income does not lose its character by reason of the nature of its receipt and state : " The exemption is conferred and conferred indelibly on a particular kind of income and does not depend on the character of the recipient......" In view of the above we consider that all the provisons of Section 10 (2) (iii) are complied with in that the money concerned was borrowed and at all material times was used and continued to be used " for the purpose of business ".

Certain cases were referred to in which for the purpose of assessment the business of the assessee had been split into two categories, for instance, *Maxse's case* (1919, 1 K.B. 647) in which the business of a journalist and the business of an editor were divided, and *Ransom's case* (1918, 2 K.B. 709) in which the business of a chemist and the business of husbandry were split. In the Ipoh case, *Somasundaram Chettiar* v. *Commissioner of Income-tax, Madras*, the Madras and Ipoh businesses were treated as distinct. That aspect does not arise before us because Mr. Patanjali Sastri argued the case on the basis, as is unquestionably the fact, that only one business was carried on by the assessee. In both the English cases cited above it must be observed that the separate enterprises were of design carried on by the assessee. For instance in *Ransom's case* no doubt the firm's directors could have bought their herbs in the market but they preferred to grow them themselves. Nor was there any obligation on Mr. Maxse to be a journalist as well as an editor. But in the case before us where is the money-lender's choice ? Here is the only method by which he can be repaid if further losses in the money-lending business are to be avoided. And how can agricultural land be preserved except by cultivation ? The cultivation was merely a necessary incident of his involuntary possession which came to him because as a money-lender he had lent money to a borrower who could not repay his money. It appears therefore that only by straining the Act against the assessee can he be excluded from the benefits of S. 10 (2) (iii). Apart from the fact that that is not the method of construing a taxing statute it appears there is nothing unreasonable in the result at which we arrive. The legislature has thought fit to exclude agricultural income from the incidence of income-tax because it has already paid the tax in another form. The position is peculiar to India and not to England and in this case we are told—and it appears to be the fact—that the assessee would be better off if he had not taken this land from the debtor and was

therefore unable to realise anything in cash as he would then be able to get the benefit of Sec. 10 (2) (iii). The argument of the Commissioner's learned counsel appears to be entirely based on the fact that agricultural income is not the subject of income tax in British India for he conceded that had the repayment of the loan to the money-lender been received in the form of a number of motor cars which could be let out on hire until a favourable opportunity to sell them arose (such profits would of course be taxable), the assessee would have been entitled to the benefits of Sec. 10 (2) (iii). The Commissioner has relied on *Sachindra Mohan Ghosh* v. *The Commissioner of Income Tax, Bihar and Orissa.* In that case a receiver was appointed by the court for the management of an estate which derived taxable and non-taxable income and the question arose what proportion of the salary of the receiver was allowable expenditure. The decision is of no assistance in this matter because it deals with income from "other sources", and Sec. 12 (2) which governs that decision permits a deduction of expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains. In the present case we are dealing with business and interest on capital borrowed for the business.

Since the arguments in this reference were concluded a report of a very recent decision of the Court of Appeal has been received in this country and has been brought to our notice: *Hughes* (*Inspector of Taxes*) v. *Bank of New Zealand* (1936) 3 All-England Law Reports 975. In that case the bank had a branch in London and from its floating capital had purchased 5 per cent. war loan which is tax free and 3 per cent. Indian Government Stock and other securities on which the amount of the tax had been repaid on the ground that there was no residence by the assessee in the United Kingdom. It was sought by the income tax authorities to tax the interest on all the above securities. The authorities further denied the right of the bank to deduct the expenses incurred by the bank for the purpose of earning the income from the above securities. The Court of Appeal after holding that the immunity from taxation of the above securities was absolute, dealt with the question whether the expenses of the bank incurred for the purpose of earning non-taxable income were properly deducted. £41,262 was found to be the expenses attributable to the earning of the profits derived from the above-mentioned securities and it would appear that very much the same argument was

advanced by the Inspector of Taxes in that case as has been advanced here. It is summarised by LORD WRIGHT at p. 997 as follows: "It is contended on behalf of the Crown that, if the bank get the benefit of that exemption, it should be deprived of the advantage of deducting this sum of £41,262 being the expenses attributable to the earning of the income which has been held to be immune from taxation. In other words, it is said, if the corpus—that is to say, the income—is to be excluded, the accessary—that is to say, the expense of earning it—ought also to be excluded. The exclusion on the one side ought to be balanced by the exclusion of the other, otherwise the taxpayer is getting a double advantage, he is getting his exemption in respect of the interest, and he is also having the additional benefit of deducting the expenses of earning that interest, just as if the interest had been included as taxable. I confess that there seems to be great force in that argument, and if I had been able to find a warrant for giving effect to that argument in the language of the Act I should certainly have done so, because it seems to me to be both a reasonable and a proper conclusion." With regard to this last observation of LORD WRIGHT, as we have already pointed out, in India a special provision is made for taxing agricultural lands so that "the double advantage" referred to is not applicable here. But at page 998 his Lordship says. "The expenses which are dealt with here by the Commissioners are interest on the money borrowed and used to purchase these particular securities, and it would be a suitable conclusion if that could be deducted." LORD WRIGHT rejected the contention that one part of the expenses could be eliminated and the trade as it were divided, observing that there was one individual trade. In the present reference as already indicated the agricultural activities of the assessee were inextricably mixed with and incidental to the money-lending business.

The above decision seems to support the view which we have expressed that in the absence of any express provision in the Act, the assessee is not to be deprived of the advantages conferred by exemptions such as Sec. 10 (2) (iii) because the capital benefitting therefrom by means of permissible deductions happens to produce a non-taxable income.

It follows from what has been stated above that the answer to the first question must be in the affirmative. The answer to the second question will admittedly follow from the decision on the first and the answer to it therefore is also in the affirmative.

The assessee will have costs of this petition fixed at Rs. 250. The Rs. 100 deposited by the assessee will be refunded.

[In the Patna High Court.]

RAJENDRA NARAYAN BHANJA DEO

v.

COMMISSIONER OF INCOME TAX, BIHAR & ORISSA.

Sir Courtney-Terrell, C. J. and James, J.

September 4, 1936.

Permanently Settled Estate—Income from Fisheries, Markets etc.—Liability to be Assessed to Income tax—Implied Repeal of Prior Treaty.

Where a Raja who was assessed to income tax claimed exemption in respect of income derived from fisheries, market rights, right of ferry etc., on the ground that under a treaty with the Government in 1803, the Government had, in view of his undertaking to pay a specified annual tribute to the Government, agreed that 'no further demand, however small, shall be made on the said Raja': Held, *that the Income Tax Act, by imposing a tax on all persons in British India without exception, must be deemed, by necessary implication, to have repealed the earlier exemption, and the income in question was taxable under the Act.*

If there be any earlier legislation or a treaty between the Sovereign power and the subject for special exemption from future taxation, followed by the introduction by the Sovereign power at a later date of legislation which admittedly, but for the claim to the earlier exemption, applies to and includes the person who was originally exempted, it follows that by necessary implication the later statute repeals the earlier statute or other Act under which the exemption is claimed.

Cases referred to :

Kutner *v.* Phillips [1891] (2 Q.B. 267).

Raja Probhat Chandra Barua *v.* Commissioner of Income tax [1930] (57 I.A. 228 ; 125 I.C. 871).

Case stated by the Commissioner of Income tax, Bihar and Orissa, under Section 66 (2) of the Indian Income tax Act, XI of 1922; Mis. Jud. Case No. 9 of 1935.

The material facts are stated in the judgment.

K. P. Jayaswal, *G. C. Das* and *Dharmashila Lal*, for the assessee.

Manohar Lal, for the Commissioner of Income Tax.

JUDGMENT.

COURTNEY-TERRELL, C.J.—The assessee for the year of assessment was a nobleman of this province. His estate is now included in the province of Orissa. He was assessed under the Income tax Act to pay tax on an income of Rs. 1,35,619. Out of this income the dispute between the assessee and the department is concerned with an aggregate sum of Rs. 21,171 comprised in four items of *sir* income, that is to say, income which is derived from his Rajaship over the estate, the four items being: in respect of fisheries Rs. 18,249, market rights Rs. 592, rights of ferry Rs. 1,884 and in respect of income derived from the sale of bones and hides Rs. 445. He claims to hold his estate by virtue of a Treaty engagement entered into by his ancestor in the year 1803 with the British Government of that day. It was entered into at a time when the British were first engaged in subjugating Orissa. There is some reason to doubt the historical accuracy of the claim made by the assessee and a considerable part of the decision of the Commissioner of Income Tax is occupied with a partial refutation of that claim. To my mind to decide that question of historical accuracy is no part of our duty, because for the decision of this case the claim made by the assessee in respect of the alleged treaty rights and privileges acquired by him may be assumed, whether the claim be sound or not. By the treaty in question the Raja of that day entered into obligations with the Government of the day by which he assumed certain specified duties towards the East India Company, then the Sovereign power of the country, and amongst other duties he undertook to pay to the Government an annual tribute of 84,840 Kahuns of Corees which was subsequently translated into Government currency at the rate of 20,408 Sicca Rupees per annum. On the part of the East India Company the engagement, it is said, was that:

'no further demand, however small, shall be made on the said Raja or received from him as nazar, supplies or otherwise.'

The assessment has been made upon the items of income amongst others which I have set forth, under Sec. 6 of the Income Tax Act as income from "other sources." it is conceded and rightly conceded on his behalf that but for the historical claim to exemption made on his behalf the income in question if considered with relation to the Income Tax Act alone is certainly taxable. Further-more it is conceded, and also properly conceded, that there is nothing in the Income Tax Act which excludes from taxation the income in question. The argument on behalf of the assessee is confined solely to this very simple point. It is pointed out that in the Income Tax Act there is no express reference to the Raja or to any one of the specific classes to which he belongs and there is no repeal of the Treaty relating to him which has statutory force. It is urged therefore that inasmuch as there is no specific repeal of the contractual or, if I may say so, that statutory relationship between himself and the Government it follows that either the Income Tax Act in its general terms cannot in the absence of such repeal, be held to apply to him, or on the other hand that the Act, in imposing upon him a taxation, which it was solemnly agreed should not be imposed upon him is *ultra vires*.

To deal with these two arguments: it is said that specific exemption from taxation cannot be abrogated by general terms in a subsequent Act imposing taxation and that there must be a specific repeal of the exemption. Mr. Jayaswal endeavoured to find authority for this proposition of law but was unable to find anything which brought conviction to my mind. If there be any earlier legislation or a treaty between the Sovereign power and the subject for special exemption from future taxation, followed by the introduction by the Sovereign power at a later date of legislation which admittedly, but for the claim to the earlier exemption, applies to and includes the person who was originally exempted, it follows that by necessary implication the later statute repeals the earlier statute or other Act under which the exemption is claimed. Indeed one of the cases to which Mr. Jayaswal on behalf of the assessee referred expressly recognised this principle. In *Kutner* v. *Philips*, SMITH, L.J., dealing with a somewhat similar argument although not in a taxation case, said:

"It is admitted on the part of the applicant that there has been no express repeal of this section; but it is argued that, by reason of the legislation which has since taken place and especially by reason of the provisions of the County Courts Act, 1888 (51 and 52 Vict. c. 43), it has been repealed by implication. Now a repeal by

implication is only effected when the provisions of the later enactment are so inconsistent with or repugnant to the provisions of an earlier one, that the two cannot stand together, in which case the maxim "*Leges posteriores contraries abrogant*" applies, the quotation being from Coke's Institutes.'

In this case if we are to assume in the assessee's favour that there was an earlier exemption from taxation, Sec. 6 of the Income tax Act, by imposing the tax on all persons in British India without specific exception, by necessary implication repeals the provision of the earlier exemption. As to the argument which, however, was not very seriously pressed, that in view of the earlier exemption and contractual relationship between the State and the assessee, the subsequent legislation imposing taxation in so far as it affected him was *ultra vires*, it cannot be contended that the legislation by the legislative authority in India in any way exceeded the powers under which the right of legislation was granted to the Indian Legislature. In support of the supposed principle, reference was made to the case in *Raja Probhat Chandra Barua* v. *Commissioner of Income tax, Bengal.* In that case the assessee was a zamindar of Assam and on his behalf there was advanced an argument somewhat similar to the argument on behalf of the assessee in this case that by reason of the circumstances of the Permanent Settlement in Bengal, the assessee was exempt from taxation upon certain non-agricultural income derived from his estate. It was claimed on his behalf that the Government had at the time of the Permanent Settlement entered into a binding engagement with his predecessor in title and persons in like position that no taxation other than the fixed revenue should be deemed from the holder of the estate.

It was urged by Mr. Jayaswal that their Lordships of the Privy Council, in deciding the case did, it is true, come to the conclusion upon a construction of the the Income tax Act that there was no exemption of the assessee from the operation of the Act, but he said that their Lordships further went on to discuss the claim of fact made on his behalf that a solemn obligation had been entered into by the Government at the time of the Permanent Settlement, that further taxation should not be levied and from the fact of this investigation by their Lordships of the Privy Counci he suggested that, had their Lordships found as a matter of fact that there had been such a prior obligation on behalf of the Government then, notwithstanding their Lordships' construction of the Income tax Act, they would have held that the Act,

however effective on other people, was not effective on the assessee in that case; but I am unable in perusing this judgment to find any indication of any such opinion on the part of their Lordships. It may be that they discussed this matter with the motive possibly of seeing whether for the benefit of historical accuracy there had been anything in the nature of a breach of faith. I do not find, however, that that part of the decision had any direct bearing in the opinion of their Lordships on the ultimate question which they had to decide. The question of whether or not this income of the assessee is taxable is, to my mind, to be decided on consideration of two points only. Firstly whether the taxing clauses of the Act did or did not affect income of the kind in question and it is not denied in this case that they do so affect the income in question, and secondly whether or not the specific income in question comes under the specified exemptions which are set forth in the Act.

It cannot be contended that the income does come under any of those specified exemptions. That the Sovereign legislative authority has inherent power to impose taxes or alter the position of any subject of the State must be beyond question and that notwithstanding any previous engagement which may have been entered into between the Sovereign power and the subject. That this principle is clear has been amply manifested in the case, to take one example only of the salary paid to His Majesty's Judges. There was certainly a solemn covenant entered into between the Government and His Majesty's Judges that their salary should be at such and such rate. There is equally no doubt that subsequent legislative enactment reduced that salary notwithstanding the covenant that was in fact passed and this enactment was perfectly valid. This was so both in England and in India. No question can therefore be entertained of any breach of covenant, however gross, and in so saying I do not wish to commit myself in any way to the view urged on behalf of the assessee that there was in this case any covenant at all. The question that was formulated for our decision was, 'whether on the terms of the Kaoolnama, dated 22nd November 1803 the petitioner's incomes from his Kanika Raj are exempt from taxation under the Taxation Act, 1922?'

I would answer this question in the negative and the assessee having failed, must pay ten gold mohurs by way of costs in addition to the Rs. 100 which he has deposited.

JAMES, J.—I agree.

Reference answered.

[IN THE SIND JUDICIAL COMMISSIONER'S COURT.]

NARAINDAS & Co.

v.

COMMISSIONER OF INCOME TAX, BOMBAY.

RUPCHAND BILARAM AND HAVELIWALA, A. J. Cs.

October 26, 1936.

REFERENCE—QUESTION OF LAW—QUESTION WHETHER ASSESSEES ARE SUCCESSORS IN BUSINESS—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 26 (2), 66.

The question whether on the facts as found, the assessees can be treated as successors in business to another and assessed on the profits which had accrued before they took up the business, is a question of law.

Application under Sec. 66 (3) of the Indian Income Tax Act to require the Commissioner of Income Tax, Bombay, to state the case of the assessees. Mis. Appln. No. 85 of 1933.

Srikishendas H. Lulla, for applicants.

C. M. Lobo, for the Commissioner.

JUDGMENT.

RUPCHAND BILARAM, A. J. C.—It is a matter of regret that this application which is under S. 66 (3), Income Tax Act, should not have come up for hearing for nearly three years. We trust that the office will exercise more diligence in seeing that such matters are brought up for hearing at an early date and if necessary orders of the Judicial Commissioner obtained for priority being given to such matters. The Commissioner of Income Tax has refused to refer this case to the Court on the ground that the only question which requires consideration is:

'Whether the petitioners can be treated as successors to the Auto Sales Co., and assessed on its profits made prior to the conveyance of its business to the petitioners'

and that as this question is purely one of fact, and as it depends upon the circumstances of the case, no question of law arises and therefore no reference can be made. But it is contended on behalf of the applicants that they do not wish to challenge the facts as found by the Income Tax authorities and that all that they contend is that the inference which is to be drawn from the facts as found is a question of law and therefore they are entitled

to have the inference drawn by the Income Tax authorities examined by this Court to see if it is correct and if on those facts the applicants can in law be treated as successors of the former company. It is common ground that Messrs. The General Motors, India Ltd., gave out franchises to different companies for the purpose of enabling them to sell their cars in the areas allotted to them. The applicants had a franchise of the Lahore area. Messrs. Auto Sales Co., Jullunder, had likewise a franchise of the Jullunder area. On 31st December 1931, The General Motors, India, Ltd., terminated the franchise of the Jullunder Company and gave the franchise to the applicants. At that time the Jullunder Company had for sale a large number of new and old cars and accessories in their possession. After the applicants obtained a franchise for the Jullunder area, they opened their shop at Jullunder, and in order to avoid competition they bought over all the assets of the Jullunder firm consisting of new and old cars, accessories and outstandings for a sum of Rs. 1,75,000 but not the liabilities of that firm for which the owners continued liable. The applicants say that on these facts they cannot be treated as successors of the Jullunder Company.

On the other hand, Mr. Lobo contends that the only inference that can be drawn from those facts is that the applicants are the successors of the Jullunder Company and that if the applicants want to have the luxury of getting an opinion from the Court, he will claim special costs. With this notice clearly given to the applicants, the learned advocate who appears for them has asked for a reference. We do not wish to say anything now one way or the other whether the inference to be drawn from these facts is that contended for by the applicants or that contended for by the opponent. That is a point which can only be decided at the hearing after the case is submitted to the Court and after all the necessary papers are before the Court. We order that the Income-tax Commissioner should state a case to this Court on the point of law which arises on the facts as found by the Income-tax authorities. As this matter is already three years old, we trust that the Income-tax Commissioner will state the case at an early date and that this office will fix the hearing on a very early date.

Order accordingly.

[IN THE CALCUTTA HIGH COURT.]

MOHANPURA TEA COMPANY, LIMITED, *In re.*

COSTELLO, J., AND PANCKRIDGE, J.

January 28, 1937.

TEA—COMPANY—TEA GROWN AND MANUFACTURED IN INDIAN STATE—SOLD IN BRITISH INDIA—WHETHER ENTIRE INCOME OR ONLY 40% LIABLE TO TAX—'AGRICULTURAL INCOME'—INCOME FROM LANDS SITUATE IN INDIAN STATE, WHETHER EXEMPT—INCOME TAX ACT (XI OF 1922), SEC. 2 (1), SEC. 4 (2), SEC. 4 (3) (viii)—INCOME TAX RULES, R. 24.

The assessees, a limited company having their registered office at Calcutta, owned a tea estate in an Indian State. They grew and manufactured tea in this estate and then sent it to Calcutta and sold it there. The assessees claimed that in view of the provisions of the proviso to sub-section 2 and sub-section (3) (viii) of Section 4 and Rule 24 of the Rules framed under the Indian Income Tax Act only 40% of the income thus derived by them from the sale of tea was assessable to income-tax: Held, *that the whole of the income of the assessees from the sale of tea accrued or arose in British India where the tea was sold and not in the Indian State where the tea was grown and manufactured; the case was governed by sub-section (1) of Section 4 of the Income Tax Act which relates to income accruing or arising in British India and not by sub-section (2) of the said section which relates to income accruing or arising without British India but received in or brought into British India; the proviso to Section 4, sub-section 2, was not, therefore, applicable to the case and the whole of the income derived by the assessees was liable to income-tax.*

Section 4 (3) (viii) does not exempt income derived from lands assessed to land revenue in an Indian State as the definition of 'agricultural income' in Section 2 (1) does not cover income from such lands.

The place where the income accrues or arises is by no means necessarily the place where the source from which it accrues or arises is situated.

COMMISSIONERS OF TAXATION *v.* KIRK (1900 App. Cas. 588) *distinguished.*

Cases referred to:

COMMISSIONERS OF TAXATION *v.* KIRK [1900] (1900 A.C. 588).

KILLING VALLEY TEA COMPANY LTD *v.* SECRETARY OF STATE FOR INDIA [1921] (I.L.R. 48 Cal. 161; 61 I.C. 107; A.I.R. 1921 Cal. 40; 1 I.T.C. 54).

PORT SAID SALT ASSOCIATION, *In re* [1932] (I.L.R. 59 Cal. 1026; 137 I.C. 340; 36 C.W.N. 555; I.R. 1932 Cal. 626; 55 C.L.J. 182; 1932 Comp. Cas. 348; 6 I.T.C. 123).

Case stated by the Commissioner of Income-tax, Bengal, under Section 66 (2) of the Indian Income-tax Act, 1922, (Reference Number 14 of 1936).

STATEMENT OF CASE.

Facts of the Case: " The assessee in this case, a limited company owning a Tea Estate in the Indian State of Tripura, has required me to refer to the Hon'ble High Court under Section 66 (2) of the Indian Income tax Act the following questions of law which according to it have arisen out of the Assistant Commissioner's order in appeal:

" I. If on a proper construction of Section 4 of the Act agricultural income derived from tea grown and manufactured in an Indian State but sold in British India is income from agriculture accruing or arising in the State and is exempt from taxation under the second proviso of Sub-section (2).

II. If 60 per cent. of the total income derived from such business should be taken as representing the income from agriculture."

2. The matter relates to the assessment for the year 1935-36 in respect of the income, profits and gains of the accounting period ended 31st December 1934. During the year of account, the assessee showed a profit of Rs. 3,721-7-9 in the revenue account against which were debited interest amounting to Rs. 2,998-7-9 and depreciation Rs. 595-8-0 resulting in a net profit of Rs. 127-8-0. The figure of profit Rs. 3,721-7-9 mentioned above was arrived at after deduction of the expenses of cultivation, manufacturing and other charges necessary for the growing, manufacture and transport of the tea from the Indian State of Tripura from where the manufactured tea is sent to Calcutta at which latter place the commodity is sold. The Income Tax Officer made the assessment on a sum of Rs. 1,029 after adding back inadmissible charges. There is no dispute about the figure Rs. 1,029 but the claim of the assessee is that 60 per cent. of the

income derived from the business of growing and manufacturing tea represents income derived from agriculture and that income from agriculture arising or accruing in an Indian State is exempt from income-tax under the provisions of the second proviso to Section 4 (2) of the Indian Income-tax Act. There is no dispute about the facts of the case. Tea is grown and manufactured in the Indian State and sent from there to Calcutta where it is sold as said above. The point for determination is whether the whole of the amount Rs. 1,029 should be taxed or only 40 per cent. of the amount. In its application under Section 66 (2), the assessee also asked me to revise the order of the Assistant Commissioner under Section 33 of the Act. But, as in my opinion, both the assessment and the appellate order are correct I cannot interfere under the section. At the same time I cannot say that no question of law arises out of the appellate order. In my opinion the only question of law that arises out of this order is:

"Whether on the facts and circumstances of this case, the whole of the income of this Tea Company has accrued, arisen or been received in British India?"

Instead of, therefore, referring the questions formulated by the assessee, I beg respectfully to refer this question to the Hon'ble High Court.

Opinion of the Commissioner.—Section 2 (1) of the Act defines agricultural income as below:—

"Agricultural income" means

(a) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land revenue in British India or subject to a local rate assessed and collected by officers of Government as such:

(b) any income derived from such land by

(i) agriculture, or

(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market, or

(iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in sub-clause (ii).

Section 4 (3) (viii) enacts that the Income-tax Act shall not apply to "agricultural income". In the case under discussion, the land is not assessed to land revenue in British India and is not

subject to a local rate assessed and collected by an officer of Government because "Government" according to Section 3 (21) of the General Clauses Act means the "Local Government" and the "Government of India" as defined in Section 3 (29) and 3 (22) respectively of that Act. The case therefore does not fall under the exemption prescribed in Sec. 4 (3) (viii). Sec. 4 (1) of the Act states:

"Save as hereinafter provided this Act shall apply to all income, profits or gains, as described or comprised in Section 6, from whatever source derived, accruing, arising or received in British India or deemed under the provisions of this Act to accrue, or arise, or to be received in British India."

We have now to see whether the case under discussion falls under Section 4 (1) or not, that is, whether income, profits or gains have accrued or arisen or been received in British India. In this case, the sale of the entire commodity has admittedly taken place in British India and the entire price has admittedly been realised there. The Hon'ble High Court in the case of the *Port Said Salt Association Limited* made the following observation:—

"By Sec. 4 the tax is charged upon profits 'accruing or arising or received' in British India and if any profit is or must be deemed to be of this character it will not be saved by the circumstance that work was done and money spent abroad in order to obtain it, Naturally the cost to the assessee wherever incurred of producing the article, transporting it and selling it must be deducted from the price obtained before the balance can be called a profit...But profit though it may be anticipated by valuation or otherwise is not realised before price and when the article is sold the whole profit is realised for the first time".

According to this decision, the whole of the profits must in such a case be taken as having accrued, arisen or been received in British India and there is no section in the Act which exempts this income from taxation.

4. The assessee has claimed that 60 per cent. of the income is exempt under the provisions of the second proviso to Sec. 4, sub-section (2), of the Act. Now this sub-section reads as below:—

"Income, profits and gains accruing or arising without British India to a person resident in British India shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be income, profits and gains of the year in which they are so received or brought,

notwithstanding the fact that they did not so accrue or arise in that year".

The sub-section describes what the expression "deemed under the provisions of this Act to accrue or arise or to be received in British India" in the concluding portion of sub-section (1) of Section 4 means, that is, income, profits or gains which have accrued or arisen outside British India to a person resident in British India are received in or brought into British India they will be deemed to have accrued or arisen in British India. In the case before us, the income has accrued in British India not in accordance with the provisions of sub-section (2) but of sub-section (1). Sub-section (2) itself not being applicable the second proviso to the sub-section cannot be brought in to support the assessee's case. Sub-section (1) of Sec. 4 describes all income, profits and gains to which the Act applies and sub-section (2) does not take anything out of sub-section (1). It rather purports to add something more and bring within the Act something which otherwise might not come within it at all.

5. The assessee relies principally on the decision in the case of the *Killing Valley Tea Company Limited.* In that case tea was grown and manufactured in British India and it was held by the Hon'ble High Court that as the operations of the assessee were a combination of agriculture and manufacture income must be apportioned and an assessment can be levied only in respect of so much of the income as can be attributed to the manufacturing process. The facts here are however different. The tea was grown and manufactured outside British India and what we have got to see is where the income accrued. The assessee has also referred me to the case of *Commissioners of Taxation* v. *Kirk* where the circumstances were that the company carried on the business of mining on lease-hold lands held from the Crown in the colony of New South Wales. A certain portion of crude ore was sold in that colony but the greater part was converted into a merchantable product in that colony. The finished commodity was sold exclusively outside New South Wales and consequently the whole income was realized outside New South Wales. But then, the question was whether any portion of the income could be said to have accrued or arisen in New South Wales by reason of the processes of extraction of ores and their conversion into merchantable product having taken place there. According to the law of New South Wales income arising or accruing in New South Wales would be liable to taxation there and consequently their Lordships

had to answer the question whether any portion of the income did so accrue there. Their Lordships in that case held that there were four processes in the earning or production of the income, *viz.*, (i) the extraction of the ore from the soil, (ii) the conversion of the crude ore into a merchantable product, (iii) the sale of the merchantable product, (iv) the receipt of the moneys arising from the sale, and that all these processes were necessary stages which terminate in the money, and the income was the money resulting less the expenses attendant on all stages. Their Lordships thus held that a portion of the income did accrue in New South Wales and as such did attract the taxation law of that country. Having held this it was not necessary for their Lordships to decide whether or not the whole income could also be said to have accrued, arisen or been received at the place where the finished commodity was sold and their Lordships did not decide that question. We, however, have the authoritative decision of the Hon'ble Judges of the Calcutta High Court in the case of the *Port Said Salt Association Limited* mentioned above that profit is not realised before price and when the article is sold, the whole profit is realised for the first time and it accrues where it is thus realised. This being so, the whole of the profit in the case under discussion has accrued within British India and has been rightly charged under the provisions of Section 4 (1) and not in accordance with Section 4 (2) in which case only the question of the application of the second proviso to that sub-section would have arisen.

6. I respectfully submit that in the circumstances stated above their Lordships will be pleased to hold that the answer to the question formulated in paragraph 2 should be in the affirmative."

Prakash Chandra Majumdar, for the assessee.

The Advocate-General, Dr. R. B. Pal and *R. C. Pal*, for the Commissioner of Income-tax.

JUDGMENT.

PANCKRIDGE, J.—The assessees are a company incorporated under the Indian Companies Act with their registered office in Calcutta. Their income, profits and gains, are derived from the sale of tea grown and manufactured on a tea estate in the Indian State of Tipperah, and then sent to Calcutta and sold there. For the year 1935-36 the Income-tax Officer assessed the company on the taxable income of Rs. 1,029 on which an income-tax of Rs. 162-10-0 has been demanded. The assessees claim that 60 per cent. of their assessed income is not liable to tax.

The assessees rely on the principle laid down in the *Killing Valley Tea Company Ltd.* v. *Secretary of State for India* (I.L.R. 48 Cal. 161) where it was held that when tea is grown and manufactured in British India a portion of the income, profits and gains derived from its sale in British India must be regarded as "agricultural income" and therefore, outside the scope of the Indian Income-tax Act by reason of Section 4 (3) (viii) of the Indian Income-tax Act. This principle has subsequently been recognised by Rule 24 made under Sec. 59 of the Act. The material paragraph of the Rule is as follows: "Income derived from the sale of tea grown and manufactured by the seller in British India shall be computed as if it were income derived from business and 40 per cent. of such income shall be deemed to be income, profits and gains liable to tax."

In the present case, however, the assessees are admittedly not entitled to the exemption provided by Section 4 (3) (viii) of the Act because tea grown in an Indian State is not "agricultural income" as defined in Section 2, sub-section (1), which limits agricultural income to income derived from land which is used for agricultural purposes and is either assessed to land revenue in British India, or subject to a local rate assessed and collected by officers of Government as such. Accordingly, if the income of the assessee is income, profits or gains, accruing or arising or received in British India within the meaning of Sec. 4, sub-section (1), the charging sections of the Act will apply.

The assessees maintain that their income is not income, profits, or gains, arising or accruing or received in British India, but they admit that but for a proviso with which I shall deal shortly, it would be income, profits or gains deemed under the provisions of the Act to be income, profits or gains received in British India within the meaning of sub-section (1). Sub-section (2) defines what income, profits or gains, shall be so deemed. The material words are as follows:—"Income, profits and gains accruing or arising without British India to a person resident in British India shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India". As I have said, the assessees admit that these words *prima facie* cover the whole of the income, profits and gains, in respect of which they have been assessed, but they rely on the following proviso to sub-section (2) introduced into the Act by the Indian Income-tax Amendment Act, 1933: "Provided further that nothing in this sub-section shall apply to income from agriculture arising or accruing in a State in

India from land for which any annual payment in money or in kind is made to the State."

The Commissioner of Income Tax has held that, in the circumstances the income, profits and gains accrued or arose or were received in British India within the meaning of Section 4, sub-section (1) and are not merely deemed under the Act so to arise or accrue or be received, and that there is, accordingly, no need to consider the meaning of the proviso.

At the request of the assessees, he has referred the question of law involved to this Court under Section 66 (2) of the Act in the following form : " Whether on the facts and circumstances of this case, the whole of the income of this Tea Company has accrued, arisen or been received in British India ". I am of opinion that the Commissioner is right in his opinion that an affirmative answer must be given to this question. I think, if one compares sub-section (1) with sub-section (2) it is clear that what sub-section (2) contemplates is a case where income, profits and gains have assumed their form as such outside British India, and are thereafter received in or brought into British India.

In the present case, what was received in or brought into British India was not income, profits and gains, but manufactured tea. Indeed, until the manufactured tea had been sold at a profit in Calcutta it can hardly be said that there were any income, profits and gains. Had the tea been sold in Tipperah and the price had either been received in Calcutta, or received in Tipperah and subsequently remitted to Calcutta, it would have been a different matter, and it may be that such a case would, *prima facie*, fall within sub-section (2) subject to the proviso as to income from agriculture.

The assessees strongly rely on the decision of the Privy Council in the case of *Commissioners of Taxation* v. *Kirk* (L. R. 1900 A. C. 588) and at first sight, this case appears to be of considerable assistance to them, but, if the language of the statute which was the subject matter of that decision is compared with the language of the Indian Income Tax Act, the differences are obvious. Under the New South Wales Land and Income Tax Assessment Act, 1895, Section 15, the following incomes are made liable to tax :

Sub-section (1) : " Arising or accruing to any person wheresoever residing from any profession, trade, employment or vocation carried on in New South Wales, whether the same be carried

on by such person or on his behalf wholly or in part by any other person ".

(3) " Derive from lands of the Crown held under lease or license issued by or on behalf of the Crown ".

(4). " Arising or accruing to any person wheresoever residing from any kind of property except from land subject to land tax as hereinafter specifically excepted or from any other source whatsoever in New South Wales not included in the preceding sub-sections ".

The assessees were a mining company with mines in the colony of New South Wales. The ore was extracted in New South Wales and was converted from a crude into a merchantable product in New South Wales. The mercantile product was, however, sold and the price paid, not in New South Wales but in Victoria. Their Lordships observe at page 592: " The word 'trade' no doubt primarily means traffic by way of sale or exchange or commercial dealing, but may have a larger meaning so as to include manufactures. But if you confine trade to its literal meaning one may ask why is not this income derived (mediately or immediately) from lands of the Crown held on lease under S. 15, sub-S. 3, or from some other source in New South Wales under sub-S. 4. Their Lordships attach no special meaning to the word " derived ", which they treat as synonymous with arising or accruing. It appears to their Lordships that there are four processes in the earning or production of this income: (1) the extraction of the ore from the soil: (2) the conversion of the crude ore into a merchantable product, which is a manufacturing process; (3) the sale of the merchantable product; (4) the receipt of the moneys arising from the sale. All these processes are necessary stages which terminate in money, and the income is the money resulting less the expenses attendant on all the stages. The first process seems to their Lordships clearly within sub-S. 3, and the second or manufacturing process, if not within the meaning of 'trade' in sub-S. 1, is certainly included in the words 'any other source whatever' in sub-S. 4 ".

The assessees in the case before us attach great weight to the passage in which it is said that " derived " should be treated as synonymous with " arising " or " accruing ". It will be observed, however, that the liability to tax depended not on whether the income arose or accrued in New South Wales, but whether it arose or accrued from a source in New South Wales.

Now the place where income accrues or arises is by no means necessarily the place where the source from which it accrues or arises is situated. This is a distinction which the argument of the assessees appears to me to overlook.

In my opinion, in the circumstances of the present case, no income, profits, or gains, arose or accrued until the manufactured tea was sold in Calcutta which is therefore, the place where the income, profits and gains arose and accrued. Accordingly, Section 4 sub-section (2) and the proviso thereto have no application and the question of law propounded by the Commissioner of Income Tax must have an affirmative answer.

The assessees will pay costs of the Reference including the cost of the advocate appearing.

COSTELLO, J.:—I agree.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

MITTAR CHAND LAKHMI DAS v. COMMISSIONER OF INCOME-TAX, PUNJAB.

JAILAL, MONROE and ABDUL RASHID, JJ.

November 23, 1936.

HINDU UNDIVIDED FAMILY—SEPARATION—MEMBERS CONTINUING FAMILY BUSINESS AS FIRM—MODE OF ASSESSMENT—LIABILITY OF FIRM TO BE ASSESSED UNDER SECTION 26 (1)—SCOPE OF SECTIONS 25-A AND 26 (1)—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 25-A, 26.

Where the members of a Hindu undivided family separate but form themselves into a firm and continue the family business, the firm is assessable under Section 26 (1) of the Indian Income Tax Act in respect of the business which was carried on by the family in the 'previous year'; and in such a case the shares of the partners are not to be included in the assessment upon the family under Section 25-A (2).

Section 25-A contemplates cases where there is disruption of a Hindu undivided family but no continuance of the business either by members of the family on a contractual basis, or by some of them alone or jointly with others, or even by strangers. Where

the business is continued Section 26 will apply, and the fact that the business is continued by all the members of the family and not by some of them alone will not render Section 26 inapplicable.

BELIRAM AND BROTHERS *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1935] (8 I.T.C. 380; 1935 I.T.R. 243) *applied.*

Case stated by the Commissioner of Income Tax, Punjab, under Section 66 (2) of the Indian Income Tax Act, 1922, in the matter of the assessment of Messrs. Mittar Chand Lakhmi Das of Rawalpindi for the assessment year 1935-36. (Civil Ref. No. 11 of 1936).

Kirparam Bajaj, for the Assessees.

Jagannath Aggarwal and *S. M. Sikri*, for the Commissioner.

JUDGMENT.

JAILAL, J.—Two questions have been referred to this Court under Section 66 (2) of the Indian Income Tax Act by the Commissioner of Income Tax, Punjab, North-West Frontier and Delhi Provinces. They are:

(1) When it is found that at the time of assessment the members of a Hindu undivided family have changed their natural family relationship to a contractual relationship or partnership, is that partnership chargeable under Section 26 in respect of business which was carried on by the family in the "previous year"?

(2) If the partnership be so chargeable, are the shares of partners to be included in the assessment upon the family under Section 25-A (2)?

Messrs. Mittar Chand Lakhmi Dass of Rawalpindi contested their assessment for the year 1935-36 which had been made by the Income-tax Officer on the basis of their income during the accounting period from 13th April 1934 to the 13th April 1935. It appears that Mittar Chand and his three sons, Lakhmi Dass, Mangal Sain and Chanan Mal, constituted a Hindu undivided family and carried on business as Produce Merchants in the name of Mittar Chand Lakhmi Dass. They also owned a family residential house. Their income was assessed to income-tax as on a joint Hindu family. On the 7th of February 1935 there was disruption of the joint Hindu family and consequent partition of the co-parcenary property. A deed was extended by the parties on the 10th March

1935 reciting this disruption and partition and on the same day a deed of partnership was executed whereby the four persons mentioned above agreed to continue the business on contractual basis with a capital of Rs. 15,000 which was deemed to have been contributed by each party. It was also recited that the family residential house had been divided into four portions and assigned to each partner separately. On these facts the learned Commissioner of Income-tax has accepted the contention of the assessee that there has been a disruption of the joint Hindu family and a partition of the family property among the various members thereof.

The contention of the assessee is that it should be assumed that from the 7th of February 1935 a firm has been newly constituted within the meaning of Section 26 (1) of the Indian Income tax Act. The contention raised on behalf of the Commissioner is that assessment of the income for the year 1935-36 should be made under Section 25-A (2) of the Indian Income-tax Act and not under Section 26 as claimed by the assessee.

It is desirable at this stage to read the two sections referred to above. Section 25-A is " Where, at the time of making an assessment under Section 23, it is claimed by or on behalf of any member of a Hindu family hitherto assessed as undivided that a partition has taken place among the members of such family, the Income-tax Officer shall make such inquiry thereinto as he may think fit, and if he is satisfied that a separation of the members of the family has taken place and that the joint family property has been partitioned among the various members or groups of members in definite portions, he shall record an order to that effect.

Provided that no such order shall be recorded until notices of the inquiry have been served on all the members of the family.

(2) Where such an order has been passed, the Income-tax Officer shall make an assessment of the total income received by or on behalf of the joint family as such, as if no separation or partition had taken place, and each member or group of members shall in addition to any income-tax for which he or it may be separately liable and notwithstanding anything contained in sub-section (1) of Section 14, be liable for a share of the tax on the income so assessed according to the portion of the joint family property allotted to him or it.

And the Income-tax Officer shall make assessments accordingly on the various members and groups of members in accordance with the provisions of Section 23 :

Provided that all the separated members and groups of members shall be liable jointly and severally for the tax assessed on the total income received by or on behalf of the joint family as such :

Section 26 is (1) : "Where, at the time of making an assessment under Section 23, it is found that a change has occurred in the constitution of a firm or that a firm has been newly constituted, the assessments on the firm and on the members thereof shall, subject to the provisions of this Act, be made as if the firm had been constituted throughout the previous year as it is constituted at the time of making the assessment, and as if each member had received a share of the profits of that year proportionate to his interest in the firm at the time of making the assessment.

(2) Where, at the time of making an assessment under Section 23 it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year".

Sections 25-A and 26 in their present form were enacted in 1928. Previously there was no section corresponding to the Section 25-A but Section 26 read as follows :—

"Where any change occurs in the constitution of a firm or where any person has succeeded to any business, profession or vocation the assessment shall be made on the firm as constituted, or on the person engaged in the business, profession or vocation as the case may be, at the time of the making of the assessment."

It is conceded at the bar that this section as now enacted has merely clarified the legal position as it existed previous to the amendment in 1928 and that it has neither extended nor restricted the scope of the provisions of the previous section. It is also conceded on behalf of the Income-tax Commissioner that but for Section 25-A the income in question of the assessee would have been assessable under Section 26. It is, however, contended that as according to the canons relating to the interpretation of statutes a special provision in a statute excludes the operation of the general provision, therefore, Section 26 does not govern the present case because it is covered by the special section, that is, 25-A. The argument of the learned counsel is that as Section 25-A applies to the income of a joint Hindu family which has disrupted and partition of the joint family property has taken place

therefore that section fully covers the present case. But, in my opinion, in this case there is a further circumstance which is not contemplated in Section 25-A and that is that the members of the joint Hindu family after partition have continued the former business on a contractual basis, and this additional circumstance, in my opinion, brings Section 26 into operation. It must be assumed that a firm has been newly constituted in this case and that it is proposed to assess that firm on the basis of the income of the person whose business the firm has continued.

Now, I must make it clear that if Section 26 were to apply merely to a firm which has been newly constituted and has not succeeded to any business which was previously carried on by another person, then legally no assessment can be made on it in advance because there is no accounting period the income whereof can be taken as a guide for the assessment. In the case of an entirely new business started by a newly constituted firm, no assessment, it is conceded, can be made during the first year. It is during the second year that an assessment can be made on the basis of the income of the first year. Section 26, therefore, applies to the case of a business which was done during the previous year but which has been continued during the year of assessment by different persons. Sub-section (1) applies to firms and sub-section (2) applies to persons and not to firms, but the same principle runs through the two sub sections.

In my opinion, therefore, Section 25-A would cover the case of a joint Hindu family in which there has been a disruption and consequent partition but no continuance of the business either by the members of the joint Hindu family on contractual basis or by some of them alone or jointly with others or even by strangers. Where the business has been discontinued Section 25-A will apply but where it is continued Section 26 will apply. This view is supported by the judgment in case No. 608 of 1934, *Beli Ram and Brothers* v. *The Commissioner of Income Tax, Punjab, North West Frontier and Delhi Provinces*, (8 I.T.C. 380) in which a Division Bench of this Court took a similar view under similar circumstances with the exception that in that case the disruption of the family had taken place after the expiry of the accounting period and within the year of assessment, the disruption in the present case having taken place within the accounting period, *i.e.*, before the commencement of the year of assessment. This, in my opinion, makes no difference because Section 26 does not make any reference to the time of disruption. It only takes into

account the factum of disruption. A further ground of distinction it is alleged, is that in the previous case only some of the members of the joint Hindu family had continued the business on contractual basis while in this case all the former members of the family have constituted themselves as a firm on contractual basis. This again, in my opinion, makes no difference because the business which was carried on by a joint family is now continued by a firm which has been newly constituted and the requirements of Section 26 have been fulfilled. The two facts mentioned above therefore are no ground for distinguishing this case from the case decided by the Division Bench.

I would, therefore, answer the first question in the affirmative and the second in the negative and would direct the Commissioner to pay the costs of the assessee of this reference which I would fix at Rs. 75 and would further direct the Commissioner to refund the deposit of Rs. 100 to the assessee.

MONROE, J.—I agree.

ABDUL RASHID, J.—I agree.

Reference answered accordingly.

[IN THE MADRAS HIGH COURT.]

THONTEPU CHINNA PULLAYYA

v.

COMMISSIONER OF INCOME TAX, MADRAS.

SIR H. O. BEASLEY, C. J., KING, J., and GENTLE, J.

March 31, 1936.

HINDU UNDIVIDED FAMILY—PARTITION—FAMILY BUSINESS CONTINUED BY ALL THE MEMBERS AS FIRM—MODE OF ASSESSMENT OF INCOME UP TO DATE OF PARTITION—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 25-A, 26 (1).

When all the members of a Hindu undivided family after separation and partition constitute themselves into a firm in order to continue the business hitherto carried on by the undivided family the assessment of the total income of the undivided family up to the date of separation and partition should be made in accordance with Section 25-A (2) of the Income Tax Act, on the

members as if no separation or partition had taken place. Section 26 (2) is not applicable to such a case as there is no change of ownership and assessment cannot be made on the firm carrying on the business as successors of the undivided family within the meaning of Section 26 (2).

Jupudi Kesava Rao v. *Commissioner of Income-tax, Madras* [1935] (1935 I.T.R. 339 ; 9 I.T.C. 64) relied on.

Case stated by the Commissioner of Income-tax, Madras, under Sec. 66 (2) of the Indian Income-tax Act. [O.P. No. 285 of 1935].

STATEMENT OF CASE.

"I have the honour to refer the following question for the decision of the Hon'ble the Judges of the High Court under Sec. 66 (2) of the Indian Income-tax Act, XI of 1922—(hereinafter referred to as 'the Act').

2. The petitioners are uterine brothers hitherto assessed as a Hindu Undivided Family by the Income-tax Officer, Rajahmundry. They derive income from property and business (trade in hardware and oils and money-lending) carried on in the name of "Thontepu Chinna Pullayya Brothers". They also derive income from the profits of a firm at Rajahmundry assessed separately.

3. For the assessment of the year 1932-33 (previous year—Telugu year *Prajothpathi* ending on 5th April 1932) the Income-tax Officer after examining the accounts produced by the petitioners assessed them as a family on a total income computed at Rs. 27,165. The assessment was made in the name of "Thontepu Chinna Pullayya Brothers" on behalf of the Hindu Undivided Family consisting of the 4 brothers as in the past. Against this assessment the petitioners appealed to the Assistant Commissioner objecting to various items of income. The Assistant Commissioner after hearing the petitioners reduced the income to Rs. 21,365.

For 1933-34 also the petitioners were assessed as a Hindu Undivided Family and this assessment has now become final. But in the course of the assessment for 1933-34, the Income-tax Officer found that the petitioners had understated their income and overstated their expenditure in respect of the account year 1931-32 by suppressing sales and showing fictitious items of purchases and expenditure. He accordingly took action under Section 34 to assess the income from "business" that had escaped assessment in tax year 1932-33 and issued a notice on 23rd March 1934 to the manager of the family. On 9th June 1934 one of the brothers filed a return on behalf of the family declaring an income amounting to Rs. 33,691 against the original assessment of

Rs. 21,365. The Income-tax Officer then called for the accounts. These were produced and were partly examined in the office and the Income-tax Officer adjourned the enquiry to 15th October 1934 to pass final orders. On this date two of the brothers alleged that there had been a partition in their family and requested the Income-tax Officer to record an order to that effect and to assess the members individually. The petitioners further contended that in respect of the business carried on by their family, they had constituted themselves into a firm under a deed of partnership dated 14th October 1934 and on the strength of this document they applied to the Income-tax Officer for registration of the firm. The Income-tax Officer then conducted an enquiry under Sec. 25-A and he came to the conclusion that there was no partition among the members of the family within the meaning of Sec. 25-A of the Act and that there was therefore no firm to be registered. He passed an order accordingly. The Income-tax Officer then proceeded to compute the income of the family that had escaped assessment. He determined the total income to be Rs. 72,071 and accordingly made a supplemental assessment on the family as in the past.

5. The petitioners preferred 3 separate appeals in respect of the supplemental assessment—

(1) against the order under Section 25-A,

(2) against the refusal to register the firm, and

(3) objecting to the computation of the income.

The Assistant Commissioner agreed with the Income-tax Officer's finding regarding the partition and registration. He accordingly dismissed these two appeals. On the merits he reduced the assessment to Rs. 56,371.

6. The petitioners then requested me to refer to the High Court five alleged questions of law marked (a), (b), (c), (d) and (e) in their application dated 30th May 1935, said to arise out of the Assistant Commissioner's order. On hearing the petitioners and examining the evidence, I found that there was a partition on 14th October 1934 within the meaning of Sec. 25-A of the Act. The petitioners are now satisfied that question (a) raised by them is covered by a previous decision of this Court, that question (b) will not arise in view of the language used at the end of Sec. 26 (2) of the Act read with rule 2 (b) of the Income-tax Rules, and that questions (c), (d) and (e) in the form in which they have been raised do not arise out of the facts of this case in view of my finding given above. They therefore withdraw

the questions raised by them but require me to refer to the Court the real question of law that arises on the facts of this case, *viz.*, whether the supplemental assessment should be made in accordance with the provisions of Sec. 25-A (2) or Sec. 26 (2). I accordingly refer the following question for the decision of the High Court.

"Whether when all the members of a Hindu Undivided Family after separation and partition constitute themselves into a firm in order to continue the business hitherto carried on by the undivided family, the assessment of the total income of the undivided family up to date of separation and partition should be made

(*a*) on the firm carrying on the business as successors of the undivided family within the meaning of Sec. 26 (2) of the Income-tax Act, or

(*b*) on the members aforesaid as if no separation or partition had taken place according to Sec. 25-A (2) of the Income-tax Act".

7. Section 25-A (2) is obviously applicable to all cases of partition of Hindu Undivided Families. Its scope has not been limited by any provision in the Act except by implication in Section 26 (2); but that section is applicable only when there is a succession. Where all the divided members of a family constitute themselves into a firm and that firm carries on the business till then conducted by the same collection of persons as family, it cannot be said that there has been a succession within the meaning of Section 26 (2). In a recent case (*Beli Ram Brothers* v. *Commissioner of Income-tax, Punjab*, reported at 3 I.T.R. 243) it was decided by the Court that on disruption of an undivided family and the continuance of the family business by three of its members as a firm, Sec. 26 applied to the case, but that case is not on all fours with the present case as *all* the members of the family did not after partition constitute themselves into a firm to carry on the business so that in that case there was a change of identity and it could be said that there was succession by 'another person'. I am therefore of opinion that on the facts of this case Sec. 25-A (2) should be applied in making the assessment in preference to Sec. 26 (2) and that the question should be answered accordingly".

M. Patanjali Sastri, for the Commissioner.

P. V. Vallabhacharlu, for the assessees.

The Court delivered the following :—

JUDGMENT.

The question referred to us by the Commissioner of Income-tax is

"Whether when all the members of a Hindu undivided family after separation and partition constitute themselves into a firm in order to continue the business hitherto carried on by the undivided family, the assessment of the total income of the undivided family up to date of separation and partition should be made

(*a*) on the firm carrying on the business as successors of the undivided family within the meaning of Sec. 26 (2) of the Income-tax Act, or

(*b*) on the members aforesaid as if no separation or partition had taken place according to Sec. 25-A (2) of the Income-tax Act".

The facts sufficiently appear in the question propounded and it is therefore not necessary to state them more fully. This point, it appears to me, has been considered and decided in *Jupudi Kesava Rao* v. *Commissioner of Income-tax* (70 M.L.J. 13), a decision of MADHAVAN NAIR, O.C.J., and STONE and KING, JJ. I need only refer to the judgment of MADHAVAN NAIR, O.C.J., where he states

"The terms 'the person carrying on any business, profession or vocation has been succeeded in such capacity by another person' may well suggest that what is contemplated is merely succession in the management of business by another person, but obviously that cannot have been the intention of the Legislature. It appears to us that the word 'succession' as used in the section connotes a transfer of ownership and the person who succeeds another must have by such succession become the owner of the business which his predecessor was carrying on and which he after the succession carries on in such capacity that is the capacity as owner. If this view is correct, as we think it is, then it seems fairly clear that the undivided Hindu family which was carrying on business has not been "succeeded" in such capacity by the petitioner as the petitioner was himself in part the owner of the property already and as such there has been no transfer of ownership in the business as he has become entitled to it by survivorship."

Applying the test laid down there to the present case, there seems to have been no change of ownership at all. All the members of the new firm were members of the undivided family and they now have the same share in the business of the firm as they had in the family business at the date of the partition. Applying

that case to this, the answer to the question propounded must be that the assessment must be in accordance with Section 25-A (2) of the Income Tax Act. The Commissioner of Income Tax will get Rs. 250 costs.

KING, J.—I agree.

GENTLE, J.—I agree.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

RAM RAKHA MAL AND SONS, LTD.

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

December 23, 1930.

HINDU UNDIVIDED FAMILY—MEMBERS FORMING THEMSELVES INTO COMPANY TO CARRY ON BUSINESS OF FAMILY—NO COMPLETE DISRUPTION—MODE OF ASSESSMENT—LIABILITY OF COMPANY TO BE ASSESSED AS SUCCESSOR—PARTIAL SUCCESSION—RATE OF TAX—RE-ASSESSMENT—FRESH NOTICE WHETHER NECESSARY—PROCEDURE—APPEAL—ADDITIONAL GROUNDS OF APPEAL—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 26-A, 26, 30 (2).

Section 25-A of the Indian Income Tax Act, applies only to those cases where the question involved is one of pure and simple disruption of a Hindu undivided family unattended by conversion, or transformation into a new entity ; Sec. 26 is intended to cover all cases which are specified in clauses (1) and (2) thereof in whatever way the situation envisaged there may arise. Therefore, if in the place of a Hindu undivided family a new firm is constituted or a new company brought into existence, assessment should be made in accordance with Sec. 26 and not under See. 25-A.

A Hindu undivided family and a firm or a limited company are mutually exclusive and cannot co-exist and accordingly without complete disruption the conversion of a Hindu undivided family into a firm or a company in its entirety is inconceivable and so long as it remains undivided, the question of succession to it as a whole by another entity does not arise.

But, as it is possible under the income tax law that a person conducting several businesses may be succeeded in a particular business which is divisible from the other businesses of his, a Hindu undivided family as a person can in the matter of such business be succeeded by a company to that extent.

Therefore where the members of a Hindu undivided family form themselves into a limited company and carry on a business of the family even though a complete partition has not been effected, the Hindu family, should still be treated as an undivided family but assessment should be made upon the company to the extent to which it is found in fact to have actually succeeded to those businesses which are separable from the rest.

The rate of income tax in cases of assessment under Sec. 26 (2) is that applicable to the successor.

Where a person upon whom a notice under Section 22 (2) read with Section 34 has been served ceases to exist, the Income tax Act does not contemplate that any fresh notice should be served upon the successor before an assessment could be made.

In making an assessment under Section 26 (2) the income is to be computed with reference to the position at the time it was earned, although by Section 26 the charge of tax computed on that basis is laid upon the successor.

The Assistant Commissioner has no power to admit a new matter raised in the form of an additional ground of appeal after an appeal has once been admitted, whether within the period prescribed therefor, or after its expiry.

Case stated by the Commissioner of Income Tax, Punjab, under Section 66 (2) of the Indian Income Tax Act, 1922. [Civil Ref. No. 9 of 1936].

STATEMENT OF CASE.

Case stated under Section 66 (2) of the Indian Income Tax Act, referring questions of law arising out of the order on the appeal of the assessee limited Company, Messrs. Ram Rakha Mal and Sons Ltd., against assessment for 1933-34 under S. 34 of the Act.

2. The above assessment was made by the Income-tax Officer, Amritsar, on 14th February 1935. Copy of his Assessment Order, and his accompanying order under Section 25-A of the Act, are annexed (A).

The assessee appealed, and the Assistant Commissioner rejected the appeal on the matters in issue, by his order of 30th August 1935. Copy of the Grounds of appeal and Appellate order are annexed (B).

The assessee has petitioned for reference of 12 questions, as of law arising therefrom. By my order annexed (C), which includes copy of those questions, I have refused consideration of certain questions not raised in appeal: and varied the form of the other questions, to present the precise issue of law actually arising. The questions which in the Commissioner's opinion properly arise and are referred, are contained below.

Facts of the case.

3. The Hindu Undivided Family of the descendants of L. Ram Rakha was assessed for many years, up to 32-33: in respect of of jewellery and Money-lending business, and Property. At the material dates these descendants comprised the three sons of Uttam Chand deceased son of Ram Rakha, (Banwari Lal, Roshan Lal, Chaman Lal): and the three sons of Tilok Chand deceased son of Ram Rakha, (Balwant Rai, Benarsi Das, Kishan Gopal—a minor).

The 1933-34 proceedings were delayed, and only taken up on 9th April 1934, by notice under Section 22 (2) with Section 34; in the family style. Two returns were made by Balwant Rai the first on 20th August 1934 without entry in the heading: the second in the usual style "Ram Rakha and Sons" on 18th November 1934: both containing nothing but entry of a loss of Rs. 49,132 under business (without particulars). I am unable to reconcile this figure with any other details in record, but it apparently was intended to be the results of accounts of the Headquarters and shop at Amritsar, and of two branch shops in Lahore.

4. In the course of the proceedings, on 2nd December 1334 the assessee filed an application dealing mainly with an item of computation in dispute: but including,

"The firm of Messrs. Ram Rakha and Sons is a Limited one, and should be assessed accordingly."

The Income-tax Officer treated this as an allegation of disruption under Section 25-A, and made enquiry under that section.

The version was that Banwari Lal had divided off in 1922, and the others disrupted in June 1934. There was no support whatever for the 1922 contention; and the matter turns wholly on what happened in 1934.

The recorded evidence is unfortunately meagre. There is a printed Memorandum and Articles of Association as a Private Company: without date, or proof of registration, or any share-allocation particulars. There are no account particulars (though some details are given in the Order, Annexure A). The verbal

evidence is fully enough summarised in the Income-tax Officer's note of 16th January 1935: thus,

"(1) Alleged separation from 18-6-34.

"(2) No written evidence; only verbal, that shares were declared.

"(3) 20 lacs is to be collected."

The Memorandum includes, besides numerous general business "Objects,"

(*a*) To acquire, and take over as a going concern all the business now being carried on at Katra Mohar Singh, Amritsar, with branches at Anarkali, Lahore, and Shahdin Buildings, the Mall, Lahore, under the name and style of "Ram Rakha Mal & Sons" and good-will thereof and all the assets and liabilities of that business in connection therewith.

(*b*) To arrange with the present owners of the aforesaid business of Messrs. Ram Rakha Mal & Sons for taking over their business as a going concern.

The capital is provided to be Rs. 20 lakhs divided into 400 shares. The Articles include,

(4) The Company shall as speedily as possible, after the incorporation of the Company, take over the assets and liabilities of Messrs. Ram Rakha Mal & Sons, Bankers and Jwellers at Amritsar and their branches at Anarkali and Shahdin Buildings, The Mall, Lahore, at values and prices to be mutually agreed between the Directors and the proprietors of Messrs. Ram Rakha Mal & Sons and to allot them shares instead or pay cash as may be mutually decided.

(*a*) The Company shall also pay to the promoters of the Company such sums as they spend in promoting this Company such as Registration fees, legal adviser's fees, printing and other preliminary charges whether incurred prior to incorporation or afterwards. Such expenses are not expected to exceed the sum of Rs. 2000.

(16) All calls in respect of shares shall be made at the discretion of the Directors and shall be payable to the persons and at the time and place appointed by them.

(24) Subject as aforesaid, the profits of the Company shall be divisible among the members in proportion to the Capital paid up or credited as paid up on the shares held by them respectively.

The Company in General Meeting may declare a dividend to be paid to the members according to their rights and interests in the profits and fix the time for payment.

The expansion of this in the Annexures is to the effect that the assets of the Family were transferred to the Company piece-meal, at valuations; and by the end of December 1934 Rs. 9·8 lakhs had been transferred, with corresponding equal credits to the six members (presumably against some sort of share allocation). The total assets to be eventually transferred were estimated by the assessee at 20 lakhs.

5. The Income-tax Officer held that the Family was "in process of partition," as yet uncompleted; and that for the purposes of the Act, under Section 25-A (3) the Family must be deemed to remain Undivided. But whatever may be said about the merits of that order, he did not apply it in any way to this assessment. I understand that he would propose to apply it to any distribution of Dividends to the members; but that he accepted the proposition that a Company being a separate legal entity must (over-riding whatever be provided in Section 25-A) be separately charged upon anything as to which the Act lays a charge thereon. In the event, this coincides with what Your Lordships decided in the case reported, at 8 I.T.C. 380; and his decision under Section 25-A is on that decision altogether without materiality to the assessment actually made.

6. The assessment comprised :—

	Rs.	Rs.	Rs.
Amritsar :			
Accounted Interest ...	50,355		
Less interest charged on a separate enterprise noted below ...	8,832		41,523
Shop, gross profits ...			8,497
Expenditure :—			
Interest debited ...	40,446		
Less to family members ...	2,748	37,698	
Other items ...		13,394	
Lahore : Anarkali shop, net income ...			2,805
Lahore : Mall shop, Gross profits ...			2,370
Expenditure—			
Salaries claimed ...	4,092		
Less to Family Members ...	2,400	1,692	
Other expense ...		6,468	
Property ...			5,148
Interest on Rani Harnam Kaur mortgage ...			61,501
Account Banwari Lal :—			
Loss, after debit of 8,832 above ...	3,130		

Add, interest debited to partner (assessee) ...	8,832		
Profit assessed on Banwari Lal (U. R. F.) ...	5,702		
Assessee's accountable share, half of 3,130 loss, plus 8,832 credit			7,267
		59,252	1,29,111
Assessee's Total Income (for Super Tax).			69,869
Chargeable income for Income Tax being the Total Income less share u-s 14 (2)			62,592

*Arithmetical error of Rs. 10 in I.T.O.'s addition.

Tax and super-tax were demanded at the rates appropriate to a Company.

7. The principal matter contested is the inclusion of the item of 61,501.

It arose from the taking over of property under mortgage dated 1919, in 1932. The present account period ("previous year") is *Sambat* 1989, beginning 7th April 1932. The original mortgage was for 40,000. The record includes no details of the further debits claimed and allowed by the Income-tax Officer, totalling 48,499. The property was taken over under deed of sale registered 11-4-32, as set out in the appellate order (para 12). The face value was put as 1,50,000. The record does not show how and when the item was accounted; but the Income-tax Officer took the difference between this face value of settlement, and the above 88,499, as assessable income accountable in this period.

The assessee contended before the Income-tax Officer only that 1½ lakhs was in excess of the real value. The Income-tax Officer found that it was not in excess.

The relevant grounds of appeal (12 to 14) dropped that contention. Ground 12 is altogether unsustainable and need not be referred to. Ground 13 alleged that the sale was not yet final, and therefore the quantum should be *reduced*—(I do not follow why). Ground 14 apparently means that the Company was not a "successor" to this item.

These grounds were laid on 23-3-35 (shortly after which date the time bar under Section 30 (2) closed).

But in July, at hearing of the appeal, he sought to make a new contention by an affidavit in the following form :

" In support of the contentions raised in appeal it is submitted that the sale of the mortgaged property was made by the

reversioner of Rani Harnam Kaur on 1-4-32. The Accounting period of the assessee is *Sambat* 1989, *i.e.*, from *6-4-32 to 26-3-33* and as such the alleged item of Rs. 61,501 wrongly computed as interest and illegally held by the Income-tax Officer as assessable income accrued on 1-4-32 does not fall within the accounting period and as such the same cannot be assessed for 33-34 assessment."

The Assistant Commissioner noted thereon,

"This is a new point which was not raised at the time of assessment, and so it cannot be taken up in appeal."

He repeated this refusal within his para 12: (though he adds that on merits the claim was unsustainable).

The assessee now seeks to bring this claim to relegate the accountable date back to 1-4-32, before the Court. I could not deal conclusively with the merits without examination of the account-treatment, as well as the transaction-deeds; but for reasons noted in Annexure C, I shall not go into those merits, nor refer the issue of accountable date. But question is being referred on the matter of the Assistant Commissioner's refusal to admit this contention as being new.

The assessee mentions that the deed of 1-4-32 was put before the Income-tax Officer. Actually what was done was to file the whole of the related documents from the mortgage to the final sale, including intermediate court and other proceedings. There is nothing in this to indicate in any way that the contention was raised earlier than in the above affidavit.

ADMITTED ISSUES OF QUANTUM.

8. As detailed in para 6 above, the Income-tax Officer did not allow deduction of 2,748 interest credited to the personal account-balances of certain family members, thus:

Banwari Lal	...	954
Balwant Rai	...	593
Benarsi Das' wife	...	388
Chaman Lal's wife	...	388
Roshan Lal's wife	...	347
Uttam Chand's widow	...	78
	...	2,748

As regards the male members, there was no contention, let alone evidence that these balances were their Individual acquisition loaned to their Family. It was alleged that the sums in the wives' names were their Istridhan; but the Income-tax Officer specifically noted that no evidence of any

kind was given to show the origin of the alleged Istridhan, let alone its "borrowing" for purposes of the assessed business. Although affidavits on other matters were tendered in appeal, no evidence of any kind was proffered on this matter. I note that the debit is a considerable increase on the totals (not recorded in detail) mentioned in previous assessments.

9. Also in the Lahore Mall shop (which appears not to have been assessed before), there was a charge for Salaries, altogether out of relation to the salaries in the other shops: (4,092). The Income-tax Officer did not examine the truth or reasonableness of this—nor of many other *prima facie* incredible items; but as he found that 2400 of this was "salary" to family members, he did not allow that amount as actual expenditure of the Family.

10. Finally, in the Amritsar accounts, Rs. 1,218 "bad debt" in account Narain Singh was claimed (in a total of 25,294 claimed, of which 19,378 was at once admitted to be not rightly allowable). Previous accounts of all the remaining items were required, and it was found that this particular item was a balance standing from 1928. No evidence of any kind was tendered, beyond the mere fact of write-off in this 32-33 account year, to show that the amount was "bad" (irrecoverable), and was ascertained to be so in this period. Certain evidence was put before the Assistant Commissioner and as described in his order (para 6-ii); and he found it insufficient to establish the claim. The present petition does nothing beyond repeating the claim.

ISSUES OF PROCEDURE.

11. The primary notice under Section 22 (2)/34 was issued (as above) to and in the style of the Family, before its conversion. Balwant Rai appeared on notice under Section 22 (4) on 2-7-34, and asked for adjournment, which was given, to 27-7-34. What he then produced was insufficient to proceed upon, and there was another adjournment, to 20-8-34. He then filed a Return (noted above), but on ground of illness obtained further extension for evidence to October. Notice under Section 23 (2) in the usual style "Messrs. Ram Rakha Mal and Sons" was served on Balwant Rai, and he appeared with various items of evidence from time to time. The claim of company status was put in, dated 2-12-34 (as above—the actual date of filing is not recorded, but is implied to be somewhat later). The Income-tax Officer then issued notices under Section 25-A to all the family members: and a notice under Section 22 (4)—it should have been under Section

23 (2)—to Balwant Rai for a material document. After recording evidence in the regard, he had made the assessment in style "Messrs. Ram Rakha Mal and Sons Ltd."

The appeal was filed in the style "Ram Rakha Mal and Sons."

Questions referred and Opinion of the Commissioner.

AS TO PROCEDURE.

12. *First Question*: Was there any material on which the Income-tax Officer could find that the assessee Company succeeded to the Business of the Family?

Opinion: Succession is of course an issue of fact. It was the assessee's own version that there had been succession, and that it was the Company that should be assessed. Actually, the details of the piecemeal succession are not really complete enough to prove succession to the whole of the subjects of assessment; but in my opinion the proper conclusion is that there was material, in the assessee's own version and evidence.

13. *Second Question*: In view of the finding under Section 25-A that the Hindu Undivided Family had not discontinued for the purposes of the Act, should assessment be made upon the Company which was found in fact to have actually succeeded to the Business?

Opinion.—The reasons which led the Income tax Officer to make assessment on the Successor, despite the finding under Section 25-A are noted in para 5 above. Since then, Your Lordships have (as there noted) held that Section 26 stands prior to Section 25-A in charging effect. In my opinion the assessment was rightly made upon the Company.

14. *Third Question.*—Is the successor Company liable to be charged under Section 28 in respect of assessment made during 34-35 for 33-34 under Section 34, upon the predecessor Family's income of the "previous year" 32-33 (*Samvat* 1939)?

Opinion.—The assessee wants to read Section 26 (2) as meaning that the assessment on a successor can only be in respect of the income of the year prior to the actual date of assessment. He overlooks the meaning given to the words "previous year" definition in Section 2 (11). I do not think the precise point is quite the same as was decided in 7 I.T.C. 337 (with 6 I.T.C. 209); but in my opinion the Section itself is clear, that the successor is so liable.

15. *Fourth Question.*—The assessee Company having succeeded to the Business in issue, after notice duly served under

Section 34 upon the Predecessor, is the Company liable to be assessed without further direct services under the Section upon the Company?

Opinion.—The Assistant Commissioner refused to admit this objection, as not having been raised at the time of assessment on the strength of 5 I.T.C. 313. I think that is a good objection, and in my opinion Your Lordships should not admit the question. But because elsewhere it has been held that an objection to the whole validity of proceedings can be raised after their completion, to avoid possible multiplication of proceedings I state the question, subject always to Your Lordships finding it admissible.

The matter has been decided in Madras, 6 I.T.C. 475. I am prepared to agree that the Successor must have adequate notice of the proceedings, on general principles of equity; but the whole history of this case shows that there was substantial continuity and identity and the assessee was actually claiming to be assessed. So far as the words of the Section take the matter, in my opinion a notice against the predecessor can be rightly founded upon as against the successor.

16. [AS TO QUANTUM] :—

Fifth Question :—Was it possible in law for the Income tax Officer to hold that the assessee had not discharged the onus upon him of establishing his claim to deduction of 2748 (credited to accounts of members of the Family and their wives) as being interest upon Capital borrowed within Section 10 (2) (iii)?

Opinion.—In so far as the credit to male members go, there was absolutely no evidence upon which the Income tax Officer could allow the credits of such charges. As regard the wives, the absence of any reasonable attempt to establish Istridhan origin, coupled with the general history of the case (detailed in Annexure C), was in my opinion full justification for the disallowance. In law, in my opinion it was possible on this state of evidence to hold the claim not proved.

17. *Sixth Question.*—Where the salary payments attributed to members of the income-earning Family, a proper deduction from the income assessed in the charge of the successor under Section 26 (2)?

Opinion.—I have indicated that it is doubtful whether these Salaries were truly and reasonably paid for services, within the scope of the "Partners' Salary" case 5 I.T.C. 254, and the somewhat peculiar "Family Firm' case 7 I.T.C. 20. But that was not the ground actually put in issue. The Income-tax Officer gave

no explanation, beyond the description "Salaries paid to the members of the Family". The grounds of appeal went no further than an unexplained claim. But the appellate order shows well enough what the issue raised was, thus :—

"These items were paid to the proprietors, hence were appropriation of profits and could not be allowed". This is the point (and the only point) the petition takes, thus :—

"The salary paid ought to have been allowed as the Company can validly remunerate the shareholders for services rendered".

What this means is a clear acceptance of the ground that these "salaries" would not have been deductible in computing the income of the proprietor; and the claim is only that the succession changes the computation of the income, when it transfers the charge thereon.

In my opinion, the question of what is income depends wholly on the nature of the transactions, at the time they occur. A later change of ownership does not change the nature of completed transaction in any way; and what was income is a matter determinable altogether without reference to the question whether it would have been of the same nature had it been paid by some one other than who actually did pay it. The income is to be computed with reference to the position at the time it was earned: although by Section 26 the charge of tax computed on that basis is laid upon someone else. I think that is the only point raised by the petition, and that the answer to the question put is in the negative.

18. *Seventh Question.*—Was it possible in law for the Income-tax Officer to hold that the assessee had not discharged the onus upon him of establishing his claim that the amount of 1218 at the debit of Narain Singh fell irrecoverable in "the previous year"?

Opinion.—The position of evidence is set out in para 10 above. In my opinion it was possible.

19. *Eighth Question.*—In the matter of interest from mortgage in account Rani Harnam Kaur, appealed upon grounds 12, 13 and 14 (Annexure B), was the contention raised by affidavit, filed at hearing on 10-7-35 out of the ordinary time limit provided in Section 30 (2), validly refused as being a new contention, not raised either at assessment or in the said grounds?

Opinion.—As noted in para 7 above in my orders in Annexure C, I have refused to refer the substantive issue. I have also refused to examine the matter on merits, for reasons noted. As

this is really the only item that makes any contest worth while, and as there would certainly be a Mandamus application if all reference thereon were refused, to avoid multiplicity of proceedings I include this question. If Your Lordships hold that the ground was not validly rejected, it will have to go back to the Assistant Commissioner for finding on merits. In my opinion the contention was validly rejected.

20. I find no other question arising on the admissible contentions of the assessee, and refer the eight questions detailed, for Your Lordships' judgment".

Kirparam Bajaj, for the Assessees.

J. N. Aggarwal, S. M. Sikri and *M. M. Aslam Khan*, for the Commissioner.

JUDGMENT.

This is a case stated by the Commissioner of Income Tax under Section 66 (2) of the Indian Income Tax Act referring the following questions of law arising out of the appellate order of the Assistant Commissioner of Income Tax in the matter of the assessment of Messrs. Ram Rakha Mal and Sons, Ltd., for 1933-34 :—

(1) Was there any material on which the Income Tax Officer could find that the assessee company succeeded to the business of the Family?

(2) In view of the finding under Section 25-A that the Hindu undivided family had not discontinued for the purposes of the Act, should assessment be made upon the company which was found in fact to have actually succeeded to the business?

(3) Is the successor company liable to be charged under Section 26 in respect of assessment made during 1934-35 for 1933-34 under Section 34, upon the predecessor family's income of the 'previous year' 1932-33?

(4) The assessee company having succeeded to the business in issue after notice duly served under Section 34 upon the predecessor, is the company liable to be assessed without further direct service under the section upon the company?

(5) Was it possible in law for the Income Tax Officer to hold that the assessee had not discharged the onus upon him of establishing his claim to deduction of Rs. 2,748 (credited to accounts of members of the family and their wives) as being interest upon capital borrowed within Section 10 (2) (iii)?

(6) Were the salary payments attributed to members of the income-earning Family, a proper deduction from the income assessed in the charge of the successor under Section 26 (2)?

(7) Was it possible in law for the Income Tax Officer to hold that the assessee had not discharged the onus upon him of establishing his claim that the amount of Rs. 1,218 at the debit of Narain Singh fell irrecoverable in the 'previous year'?

(8) In the matter of interest from mortgage in account Rani Harnam Kaur appealed upon grounds 12, 13 and 14, was the contention raised by affidavit, filed at hearing on 10th July 1935 out of the ordinary time limit provided in Section 30 (2) validly refused as being a new contention, not raised either at "assessment or in the said grounds."

In order to realise fully the true implications of the first three questions of law stated above, it will be necessary briefly to state the facts of the case. The pedigree of the family with which we are concerned is as follows:—

L. Ram Rakha (deceased).

L. Uttam Chand (deceased) — L. Tilok Chand (deceased).

Sons of L. Uttam Chand: Banwari Lal Roshan Lal Chaman Lal

Sons of L. Tilok Chand: Balwant Rai Benarsi Das Krishen Gopal (minor).

This family constituted a Hindu undivided family and had been assessed to income tax as such until the time the present dispute arose. Until 1923-24 the business of the family was done in the name of Ram Rakha Mal Tilok Chand. Subsequently, the business was conducted under the style of Ram Rakha Mal & Sons (hereinafter called the assessee). It appears that in 1933-34, no notice was served on the assessee calling upon him to furnish the usual return. On the 16th May 1934 notice was for the first time issued to the assessee under sub-section (2) of Section 22 read with Section 34 of the Income Tax Act. On the 18th July 1934, the family converted itself into a private limited company under the style of Ram Rakha Mal & Sons, Ltd., all the adult male members of the family becoming the shareholders of the said company. On the 20th August 1934, the assessee furnished a return showing a loss of Rs. 49,132-6-9. On the 18th November 1934 another return was furnished showing the same amount of loss. During the course of the assessment proceedings, the assessee represented that the family had disrupted virtually in 1922 but

definitely on the 18th June 1934, since when the business of the family had been transferred to a limited company. Thereupon the Income Tax Officer issued notices under Section 25-A to the members of the family and held an enquiry as provided for in sub-section (1) of that section. He however came to the conclusion that the assets of the family had not been transferred to the company in their entirety nor had they been divided in any manner either in the account books of the family or in the books of the company and that the most that could be said was that the family was in the process of partition. He, accordingly, *held* that the family should be deemed for the purposes of the Act to continue to be a Hindu undivided family. This order was made on the 14th February 1935. Simultaneously, an assessment order was made on the same date and the assessee was for the purposes of the income tax of the assessment year treated as a limited company, having succeeded to the business of the Hindu undivided family and thus being liable to be assessed as a limited company presumably under the provisions of sub-section (2) of Section 26 of the Income Tax Act. From this order the assessee preferred an appeal to the Assistant Commissioner raising various points of law arising from the case. The Assistant Commissioner with a slight modification in the estimate of income upheld the order of the Income Tax Officer. The assessee then moved the Commissioner who as stated above has eventually referred the questions of law as set forth above with his opinion thereon.

The first two questions of law referred to us can be disposed of together. They rest on the determination of the main question whether in face of the finding of the Income Tax Officer that the Hindu undivided family was still in the process of partition and had not disrupted, the assessee could be treated as a limited company for the purpose of assessment. The assessee contends that sub-section (3) of Section 25-A is conclusive on this matter, and that when once an Income Tax Officer finds that the family has not been partitioned, the only order that he can lawfully make is the one contemplated by that section and the assessee cannot but be treated as a Hindu undivided family. He further urges that even if it be held that the family has been replaced by a company in any way, sub-section (2) of Section 26 does not apply as, in the first instance, no change of ownership takes place in the circumstances within the meaning of sub-section (2) of Section 26, and secondly, the notion of partial succession is repugnant to law. As against this, it has been urged on behalf of the Commissioner that in spite of a find-

ing under sub-section (3) of section 25-A, if a Hindu undivided family carrying on business as such is found to have been succeeded by any other person contemplated by law, sub-section (2) of section 26 comes into play. It is further added that in the case of an assessee conducting two or three separate businesses, succession is possible to a particular business which is separable as a whole from the other activities of the assessee.

This necessitates a close examination of section 25-A and section 26. Section 25-A is headed "Assessment after partition of a Hindu undivided family." Sub-section (1) of that section provides for a claim being made by any member of a Hindu family hitherto assessed as undivided that a partition has taken place among the members of such family. As soon as such a claim is made, the Income-tax Officer is enjoined to make an enquiry into the matter. If he arrives at the conclusion that the claim as made is substantiated, he is required to pass an order to that effect and make the assessment in accordance with sub-section (2) of that section: on the other hand, if he finds that the claim is not established and he does not consequently pass the order referred to above, sub-section (3) makes it incumbent upon him to treat the family as a Hindu undivided family.

Section 26 is divided into two sub-sections. Sub-section (1) is headed "Change in constitution of a firm," and sub-section (2) is headed "Change of ownership of business." Sub-section (1) provides for those cases where a change has occurred in the constitution of a firm, or a new firm is constituted and sub-section (2) deals with the situation when it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person. 'Person' as defined in clause (9) of section 2 of the Income-tax Act includes a Hindu undivided family, and 'Person' as defined in the General Clauses Act, 1897 includes any company, or association or body of individuals, whether incorporated or not.

Considering that in the matter of the interpretation of statutes, our first effort should be to reconcile the various provisions of an enactment with one another and to assign to the clear words of a statute the meaning which they ordinarily carry and thinking at the same time that the Legislature has not been guilty of redundance of expression or repetition of subjects, the irresistible conclusion to which we are driven is that so far as the scheme of the Act goes, (a) each section deals only with the matters specified therein and goes no further, and (b) each

section completely covers the matter with which it deals. Section 25-A in our view applies only to those cases where the question involved is one of pure and simple disruption of a Hindu undivided family unattended by conversion or transformation into a new entity. It is on this account that sub-section (1) of section 25-A limits the enquiry to be made by an Income-tax Officer to the solitary question, whether separation of the members of a Hindu undivided family has taken place and the family property has been partitioned. The remaining two sub-sections are merely complementary of the first sub-section and deal with only those matters which arise therefrom. If it is further borne in mind that it is not impossible that a Hindu undivided family may disrupt without transforming itself into a firm or converting itself into a company, the interpretation put by us upon this section does not appear to be unreasonable.

In the same manner, section 26 is intended to meet completely those cases which are specified in sub-sections 1 and 2 thereof respectively, in whatever way the situation envisaged there may arise. If, therefore, in the place of a Hindu undivided family, which is a person, a new firm is constituted or a new company brought into existence, which again is a person, it cannot be urged that the provisions of sub-section (1) or sub-section (2), as the case may be, are not attracted, simply because there exists a section which expressly deals with the disruption of a Hindu undivided family.

The only question, therefore, that requires determination in this connection is whether a Hindu undivided family so long as it remains undivided, can convert itself into a firm, or to be succeeded by a Company, or whether it must cease to exist or, in other words, disrupt itself entirely before it can take a new shape in its entirety. In our view, a Hindu undivided family and a firm or a limited Company are mutually exclusive and cannot co-exist, the main feature of a Hindu undivided family being "jointness of tenancy with a right of survivorship amongst its constituents and the chief characteristic of a firm or a Company being separateness of interest and no survivorship. We are accordingly of opinion that without disruption the conversion of a Hindu undivided family into a firm or a Company in its entirety is inconceivable and that so long as it remains undivided, the question of succession to it as a whole by another entity does not arise.

In the present case there is a clear finding of the Income-tax Officer that the family is still in the process of partition and that

there has not been complete partition in the eye of the law. In these circumstances, we consider that it could not be held that the family had been entirely replaced by a limited Company.

The matter, however, does not end here. It is contended on behalf of the Commissioner that the family in this case can still be treated as having been succeeded by a limited Company to the extent that it is admitted to have been replaced by a limited Company. He urges, as remarked before, that partial succession is not unknown to law and refers in this connection to *Kalumal Shorimal* v. *Commissioner of Income Tax*, *V.R.S.A.R. Arunachalam Chettiar* v. *Commissioner of Income Tax*, *Best & Co.* v. *Commissioner of Income Tax*, and *Commissioner of Income Tax* v. *Sind Light Railway*. In *Kalumal Shorimal* v. *Commissioner of Income Tax*, on a partition of a Hindu undivided family the assessee got the family business as his share, the other coparceners, the assessee's sons, relinquishing their rights therein and starting a separate business of their own. The assessee continued to carry on the business under the old name and style, retaining the account books with the right of realising the business's outstanding amounts. In those circumstances, it was held by a Division Bench of this Court that there was no discontinuance of the business within the meaning of section 25, sub-section (3), of the Income-tax Act and that as a result of the partition, the assessee succeeded the family business within the meaning of section 26.

In *V. R. S. A. R. Arunachalam Chettiar* v. *Commissioner of Income Tax*, a Special Bench of the Madras High Court held that section 26 was applicable to the case of an assessee, a member of a Hindu undivided family (which owned a share in a foreign money-lending business) who got *inter alia* the family interest in the foreign business as his share in the partition of the family. Sir C. V. Kumaraswami Sastriar, who delivered the judgment, remarked " Prior to the partition all the members of the joint family constituted a firm. By reason of the partition certain members who constituted the firm ceased to have interest in the firm and their interest by reason of the partition devolved on the person or persons to whom their share in the business have been allotted. "

In *Best & Co.* v. *Commissioner of Income Tax*, Messrs. Best and Company, Limited, has sold one of their businesses to a new Company floated for acquiring that business as a going concern.

In *Commissioner of Income Tax* v. *Sind Light Railway*, the Sind Light Railway Company was the assessee. It

had constructed on Government land two light Railways in pursuance of two separate agreements with the Government of India. Sometime later Government took over one of the railways and paid the Company 60 per cent. of the income for 9 months as profit and compensation. It was held by the learned Judicial Commissioners of Sind that the "Government had succeeded to the Company's separate and distinct business within the meaning of Sec. 26, sub-section (2), and consequently the Company was not assessable on the profits made for the period of 9 months.

It would appear that these cases do not throw any light on the question at issue before us, inasmuch as in the first two cases partition had already taken place and in the last two cases the assessee was not a Hindu undivided family.

The assessee, on the other hand, contends that in the first instance partial partition and partial succession are not recognised by Hindu Law, and secondly, if a Hindu undivided family is succeeded by a Company wholly or partially, no change of ownership takes place within the meaning of sub-section (2) of Sec. 26. The assessee has not cited any authority in support of his first contention, nor has he developed this point in the course of his arguments, while in connection with his second contention he has relied on a recent decision of the Madras High Court in O.P. No. 285 of 1935, *Thontepu Chinna Pullayya* v. *Commissioner of Income Tax*, as well as *Jupudi Kesava Rao* v. *Commissioner of Income Tax*.

The question that was referred to the Special Bench in O.P. No. 285 of 1935 was whether when all the members of a Hindu undivided family after separation and partition constitute themselves into a firm in order to continue the business hitherto carried on by an undivided family, assessment of the total income of the undivided family up to the date of separation and partition should be made (a) on the firm carrying on the business as successors of the undivided family within the meaning of Sec. 26 (2) of the Income-tax Act, or (b) on the members aforesaid as if no separation or partition had taken place according to Sec. 25-A of the Income-tax Act. Relying on a previous Judgment of their own court reported as *Jupudi Kesava Rao* v. *Commissioner of Income Tax*, the learned Judges held that the word 'succession' as used in Sec. 26 (2) connoted a transfer of ownership which could not be predicated of a succession by a firm to a Hindu undivided family which already owned the business. The answer they, therefore, gave to the question propounded was that

the assessment must be in accordance with Sec. 25-A, sub-section (2) of the Income tax Act. With all respect, we are not prepared to endorse this opinion. Sitting as a Division Bench, we recently disposed of a case in which a similar question arose and we came to the conclusion that where a Hindu undivided family is found to have disrupted and is replaced by a new firm, the case is taken out of the pale of Sec. 25-A and is governed by Sec. 26. See *Beli Ram & Bros.* v. *Commissioner of Income Tax.* Later, the same principle has been re-affirmed by a Full Bench of this Court, though worded differently, in "In the matter of *Messrs. Mittar Chand Lakshmi Das.*" See C.R. 11 of 1936. The principle enunciated in these cases gains support from *Nihalchand Kishore Lal, In re,* where a Division Bench of the Allahabad High Court, in a case in which a certain firm first carried on business in the capacity of a Hindu undivided family and was later converted into a partnership with specified shares, held that the registered firm on the date that it was constituted became the successor of the Hindu undivided family in the carrying on of the business. Similarly, in *Ryhope Coal Co. Ltd.* v. *Foyer* (1 Tax Cas. 343) decided by the High Court of Justice in England, it was held in a "case where a private partnership had been converted into a Company with limited liability that such conversion created a succession contemplated by law. In the course of his judgment Grove J. remarked as follows: "There was undoubtedly a change in the partnership and a very important change when the concern was converted from an ordinary partnership into a limited liability Company."

The other case relied on by the assessee reported as 9 I.T.C. 64 is also distinguishable. There a notice had been served on G. as manager of a Hindu undivided family. G. died during the assessment proceedings leaving a son who continued to carry on the family business. A question arose whether the assessment could be made under Section 26, sub-section (2). It was held that in the circumstances of the case the assessee who was already a part-owner of the business becoming entitled to the family business by survivorship had not succeeded to the business within the meaning of Section 26 (2) and hence was not liable to be assessed thereunder.

Though the authorities cited for the commissioner do not afford any help to him, yet on general principles we are disposed to agree with the contention raised by him that partial succession to a Hindu undivided family is not repugnant to any notion of law.

Under Hindu law, a Hindu undivided family can through its *karta* alienate a part of its property to a stranger without affecting its own status in any manner. The alienee can even claim partition on the basis of his own acquisition. If an alienation can be made to a stranger we do not consider that a replacement by a stranger cannot take place. As already observed, a Hindu undivided family is a different person altogether from a Company; its rights, its obligations, its privileges and its constitution are altogether different from the rights, obligations, privileges and constitution of a Company, and as it is possible under the Income Tax Law that a person conducting several businesses may be succeeded in a particular business which is divisible from the other businesses of his, a Hindu undivided family as a person can in the matter of such business be succeeded by a Company to that extent. This conclusion in our "view does not come into clash with the conclusion at which we have arrived above that in case a finding is arrived at by an Income Tax Officer that a family has not disrupted, a Hindu undivided family is to be deemed to continue to be a Hindu undivided family.

The question of rate was also raised in the course of arguments but that need not be discussed at length, as it is concluded by the decision of their Lordships of the Privy Council in *Commissioner of Income Tax, Bombay* v. *Western India Turf Club Limited* [I. L. R. 52 Bom. 1237]. Even the language of sub-section (2) itself is clear on the point. The assessment on the successor is to be made as if he had been carrying on the business, profession or vocation throughout the previous year and as if he had received the whole of the profits for that year.

Our answer to question No. 1, therefore, is that there was no material on which the Income Tax Officer could find that the assessee Company succeeded to the business of the family in its entirety; and our reply to question No. 2 is that though the Hindu undivided family in this case had to be deemed to be an undivided family in face of the finding that no disruption had taken place, the assessment could be made upon the company to that extent to which it was found in fact to have actually succeeded to those businesses which were separable from the rest.

Question 3.—In view of our answers to the first two questions, the answer to this question need not detain us long. The language of sub-section (2) of section 26 is too plain in this respect to require further elucidation. Our answer to this question, therefore is that the limited company, to the extent that it succeeds to

the Hindu Undivided family, is liable to be charged as a successor in respect of the 1933-34 assessment made during 1934-35 under Section 34.

Question 4.—This question relates to the validity of the assessment in the absence of a formal notice served on the successor. The assessee contends that inasmuch as before the assessment was made, the person on whom the notice had originally been served ceased to exist, though partially, and another person came into being in relation to those separable businesses to which he had succeeded, no order could be made *qua* the latter without serving upon him a fresh notice under Section 22 or Section 34. Apart from the fact that objection was not raised at the time of the assessment and could not be raised before the Assistant Commissioner as a matter of right, there is no substance in it even on the merits. The Income-tax Act does not contemplate any fresh notice to be served upon the successor, inasmuch as the proceedings once started against the predecessor continue against the successor even if the predecessor has ceased to exist. In the absence of any clear direction to the contrary no obligation is imposed upon the department in this behalf. We accordingly hold that no fresh notice was necessary in the case of the successor who will now be liable as such to the extent indicated above.

Questions Nos. 5 and 7 are questions of fact and cannot be raised before us. The only objection covered by these questions is that the Income-tax Officer was not right in holding that the assessee had failed to discharge the onus that lay upon him. There is abundant authority for the proposition that the question whether a party has discharged the onus or not is a question of fact. In I.L.R. 11 Lah. 199, P.C., the appellate Court had come to the conclusion that the onus upon the appellant had not been discharged, and their Lordships of the Privy Council relying on a previous judgment of their own in I.L.R. 46 Cal. 189, P.C., observed that the question whether a fact has been proved when evidence for and against has been properly admitted is necessarily a pure question of fact. It may also be remarked in this connec- that the assessee gave up question No. 7 before us.

Question No. 6 must be answered in the negative. The Commissioner has discussed the matter fully in the opinion submitted by him on that question, and we do not find any such flaw in the reasoning employed by him as to justify a different

answer. We entirety agree with him that "the income is to be computed with reference to the position at the time it was earned, although by section 26 the charge of tax computed on that basis is laid upon someone else."

Question 8. The only matter referred to us in this question is whether the Assistant Commissioner validly refused to entertain a new contention not raised either at the assessment or in the grounds of appeal submitted to him. First, on the authority of 104 P.R. 1917 P.C., we consider that if an officer vested with the discretion to do or not to do a particular thing, does not misdirect himself in law, or in other words, does not exercise his discretion arbitrarily, we will not be justified in interfering with it. Secondly, on the interpretation that we put upon the relevant provision of sub-section (2) of section 30, we are of opinion that an Assistant Commissioner has no authority under that sub-section to admit a new matter raised in the form of an additional ground of appeal after an appeal has once been admitted, whether within the period prescribed therefor, or after its expiry. All that he can do under this enabling provision is to admit an appeal for the first time even if it is presented after the period prescribed therefor. At first sight, this proposition may look startling but a reference to the provisions relating to appeals under the Code of Civil Procedure will make our meaning clear. The period of limitation for presenting such appeals is prescribed in the Schedule appended to the Indian Limitation Act. In the main Act, section 5, has been enacted to confer authority upon the appellate Courts to admit appeals in certain circumstances even after the expiry of the period of limitation prescribed therefor. In spite of the power so vested in the appellate Courts, the legislature has specifically provided in rule 2 of Order XLI for the admission of additional grounds of appeal and has enabled the appellants to urge any ground not taken before, by leave of the court. The discretion vested in the courts in this matter is not circumscribed within those limits, within which it is hedged under section 5 of the Limitation Act. No such provision, however, has been made in the Income-tax Act, which relating to the matters expressly dealt with therein is self-contained. It would be clear, therefore, that when once a memorandum of appeal has been put in under section 30, no new matter can be raised afterwards. We, accordingly, hold that the Assistant Commissioner's refusal which is being challenged in this question, was warranted by law.

We answer the questions propounded by the Commissioner accordingly. As a result, the assessee, in answer to questions Nos. 1, 2 and 3 will be liable to be assessed as a limited Company in relation only to his jewellery business in Lahore, which have been admitted before us to have been transferred to the Company, and for the rest, the assessee will be treated as a Hindu Undivid- Family. The answer to all other questions will go against the assessee.

In view of the peculiar circumstances of the case, we leave the parties to bear their own costs.

Reference answered accordingly.

Cases referred to:

V.R.S.A.R. ARUNACHALAM CHETTIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS [1929] (33 L.W. 541; A.I.R. 1929 Mad. 769; 57 M.L.J. 300; 122 I.C. 739; 3 I.T.C. 441).

BELI RAM & BROS. *v.* COMMISSIONER OF INCOME TAX, [1935] (1935 I.T.R. 103 and 243; A.I.R. 1935 Lah. 276; 156 I.C. 883; 8 I.T.C. 380).

BEST & CO. LTD. *v.* COMMISSIONER OF INCOME TAX [1932] (I.L.R. 55 Mad. 832; 63 M.L.J. 15; 138 I.C. 485; A.I.R. 1932 Mad. 434; 6 I.T.C. 92).

BRIJ INDAR SINGH *v.* LALA KANSHI RAM [1917] (44 I.A. 218; 104 P.R. 1917; 42 I.C. 43; 15 A.L.J. 777; 19 Bom. L.R. 866; 22 C.W.N. 469; 26 C.L.J. 572; 33 M.L.J. 486; 6 L.W. 392).

COMMISSIONER OF INCOME TAX *v.* SIND LIGHT RAILWAY [1932] (138 I.C. 673; A.I.R. 1932 Sind 189; 6 I.T.C. 271).

COMMISSIONER OF INCOME TAX *v.* WESTERN INDIA TURF CLUB [1925] (55 I.A. 14; I.L.R. 52 Bom. 123; 30 Bom. L.R. 105; 107 I.C. 642; A.I.R. 1925 P.C. 1; 2 I.T.C. 227).

JUPUDI KESAVA RAO *v.* COMMISSIONER OF INCOME TAX [1935] (1935 I.T.R. 339; 1935 M.W.N. 1937; 70 M.L.J. 13; 9 I.T.C. 64).

KALUMAL SHORI MAL *v.* COMMISSIONER OF INCOME TAX [1928] (117 I.C. 228; A.I.R. 1928 Lah. 461; 3 I.T.C. 341).

MITTAR CHAND LAKHMI DAS, *In re* [1937] (1937 I.T.R. 127).

NAFAR CHANDRA PAL *v.* SHUKUR SHEIK [1918] (45 I.A. 183; I.L.R. 46 Cal. 189; 23 C.W.N. 345; 9 L.W. 552; 51 I.C. 760).

NIHALCHAND KISHORE LAL, *In re* [1927] (I.L.R. 49 All. 611; 25 A.L.J. 366; 102 I.C. 189; A.I.R. 1927 All. 397; 2 I.T.C. 338).

RYHOPE COAL COMPANY, LTD. *v.* FOYER [1881] (7 Q.B.D. 485; 1 Tax Cas. 343).

THONTEPU CHINNA PULLAYYA *v.* COMMISSIONER OF INCOME TAX [1937] (1937 I.T.R. 132; 9 I.T.C. 377).

WALI MUHAMMAD *v.* MOHAMMAD BAKSH [1930] (I.L.R. 11 Lah. 199; 31 P.L.R. 145; 32 Bom. L.R. 380; 51 C.L.J. 518; 59 M.L.J. 53; 1930 A.L.J. 292; A.I.R. 1930 P.C. 91).

[IN THE MADRAS HIGH COURT].

TANJORE PERMANENT FUND LTD.

v.

COMMISSIONER OF INCOME TAX, MADRAS.

MADHAVAN NAIR, STONE, and KING, JJ.

September 26, 1935.

MUTUAL BENEFIT SOCIETY—INCOME FROM LOANS MADE TO SHAREHOLDERS—WHETHER ASSESSABLE INCOME.

The assessee, the Tanjore Permanent Fund Ltd., was a company incorporated under the Indian Companies Act, 1882. The Company started with 2,222 shares of Rs. 45 each and a nominal capital of Rs. 99,990. The amount of each share was payable in monthly instalments of Re. 1 and the share account of each shareholder was closed on the expiry of 45 months by his being paid Rs. 50. The fund accepted deposits from its shareholders on which interest was allowed to them. The collections of the Fund were lent to the shareholders at specified rates of interest on the security of the shares or other properties. The Fund did not accept deposits from or give loans to outsiders. The question being whether the profit derived by the Fund from the shareholders was assessable to income-tax: Held, *following the decision in Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd. (47 Mad. 1) that the Fund, though registered as a company, was not really a company but a mutual benefit society with a fluctuating capital and the income in question was not assessable. There was no conflict between the decision in the Mylapore Hindu Permanent Fund Case (supra) and that in the case of the Madura Hindu Permanent Fund (56 Mad. 415). The latter case dealt with a different question altogether, namely, whether the guaranteed interest paid to the shareholders was an allowable deduction as interest on borrowed capital.*

Cases referred to:

BOARD OF REVENUE *v.* MYLAPORE HINDU PERMANENT FUND [1924] (1 I.T.C. 217; 47 Mad. 1; 76 I.C. 833; A.I.R. 1923 M. 684).

MADURA HINDU PERMANENT FUND LTD. v. COMMISSIONER OF INCOME TAX, MADRAS [1939] (56 Mad. 415; 6 I.T.C. 326; 1933 I.T.R. 46).

SIVAGANGA SRI MEENAKSHI NITHI v. COMMISSIONER OF INCOME TAX, MADRAS [1934] (8 I.T.C. 83).

Case stated by the Commissioner of Income Tax, Madras, under Sec. 66 (2) of the Income Tax Act [O.P. No. 146 of 1935].

STATEMENT OF CASE.

I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Section 66 (2) of the Indian Income-tax Act (hereinafter referred to as the Act).

2. The petitioner, the Tanjore Permanent Fund, Ltd., (hereinafter referred to as the Fund) is a company incorporated in 1901, under the Indian Companies Act, VI of 1882, now Act VII of 1913. A copy of its Memorandum and Articles of Association is appended (Exhibit A).

3. The objects of the Fund as set out in paragraph 3 of the Memorandum of Association are:—

(*a*) to enable persons to save money;

(*b*) to invest their savings in landed property and Government Promissory Notes;

(*c*) to secure loans at favourable interest on the security of immoveable property situate within the District of Tanjore, of jewels, of agricultural produce and other goods of commercial value, of Government promissory notes and other approved securities but not upon personal security;

(*d*) and to do all such other things as are incidental or conducive to the attainment of the above objects.

The liability of the members is limited.

4. The nominal capital of the Fund at its inception was Rs. 99,920 divided into 2,222 shares of Rs. 45 each payable in monthly instalments of Re. 1. This nominal capital has been raised from time to time. According to the Balance Sheet as on August 15th, 1931, the nominal capital is Rs. 54,00,000 divided into 1,20,000 shares of Rs. 45 each payable in monthly instalments of one rupee. A shareholder is at liberty to pay at any time the balance of the subscribed capital in advance; such payments entitled him to a reduction in the amount payable (Art. 4 and Schedule A). The share account of each shareholder is closed on the expiry of 45 months from the last date of the month in which he was admitted, by his being paid Rs. 50 (Art. 10). The difference between the amount subscribed by him and the amount

paid to him by the Fund at the end of the 45th month, viz., Rs. 5 is called the "guaranteed interest". Shareholders are at liberty to decrease, transfer, sell or withdraw their shares within 45 months from the date of their admission (Art. 7). If a shareholder dies before the close of 45 months from the date of his admission into the Fund, his legal representatives may continue the share (Art. 45). The Fund accepts deposits from its shareholders on which interest is allowed to them (Art. 46). The Directors are authorised temporarily to borrow from time to time such sums as may be necessary when the cash balance of the Fund is not sufficient to carry on its transactions (Art. 56). The collections of the Fund are used to lend to the shareholders (Art. 11) at specified rates of interest (Art. 36). Loans are granted to the shareholders on the security of the shares held by them and also of their other properties, moveable and immoveable (Art. 11). The Directors are authorised to invest monies belonging to the Fund with other banks or Co-operative Societies or in Government securities, Treasury bills or Post Office cash certificates (Art. 56).

5. The Fund's main source of income is the interest on the loans advanced to the shareholders. It also derives income from interest on deposits with banks, interest on securities, discount on Treasury bills, house rent, appraiser's fees, entrance fees and other minor items. Out of the gross income of each year the following expenses are deducted :—

(1) Guaranteed interest at Rs. 5 per share matured in the year. (2) Interest on the deposits received from the members and on the amount borrowed from others, if any and (3) Management and other expenses, *e.g.*, rent, rates, taxes, depreciation, etc.

The balance is the net profit of the year, out of which 70 per cent. is divided among the shareholders "with reference to both the number of their respective shares and the number of months during which they have held them". The balance, after paying the legal adviser's remuneration and bonus to the establishment which the Directors are to fix each year is carried to the Reserve Fund (Arts. 50 and 51).

6. The number of shareholders on August 16, 1930 was 8,626 with 1,08,010 shares. During the year 16th August 1930—15th August 1931, 38,172 shares were taken by 4,447 shareholders. During the year there were 1,185 withdrawals representing 10,456 shares. 24,977 shares matured during the year. 9,984 shareholders with 1,10,740 shares and a subscribed capital of Rs. 49,83,300 were on the register on August 15th, 1931. The

paid up capital on this date including subscription on fully paid up and matured shares amounted to Rs. 23,41,879, deposits Rs. 5,99,064 and over-draft, Rs. 32,500. The reserve fund stood at Rs. 2,02,296. A copy of the Fund's Balance Sheet as at 15th August, 1931, is filed (marked Exhibits B and C).

7. For the assessment of the year 1932-33 (previous year August 16th, 1930 to August 15, 1931), the Fund returned an income amounting to Rs. 14,178 as below :

	Rs.	A.	P.	Rs.	A.	P.
Net profits as per Profit and Loss account (Exhibit C.) ...				64,699	8	0
Deduct:						
Net receipts from share-holders ...	50,373	15	0			
1/6 of 884 being annual letting value of properties	147	0	0	50,520	15	0
Balance being profits from non-members ...				14,178	9	0

This consisted of the following items:—

	Rs.	A.	P.
(1) Interest on securities including Treasury bills ...	12,040	0	0
(2) Interest on deposits with banks ...	1,048	0	0
(3) Income from house property (884—884/6) ...	737	0	0
(4) Rent and commission ...	353	0	0
Total ...	14,178	0	0

The Fund's receipts from its shareholders on account of interest on the loans advanced to them and other receipts, *e.g.*, surveyor's fees, appraiser's fees, entrance fees etc. the disbursements to the members on account of guaranteed and deposit interest and the management and other charges were excluded from the Profit and Loss statement for the purposes of the assessment on the ground that the Fund was a mutual benefit society and therefore the receipts from shareholders were not income liable to assessment under the Act, in accordance with the past practice based on the decision of this Court in *Secretary, Board of Revenue* v. *The Mylapore Hindu Permanent Fund Ltd.* The net receipts on this account during the year in question amounted to Rs. 61,304 as shown below :

Interest on loans received from shareholders.					2,33,863	0	0
Other receipts, *e.g.*, Surveyor's fees etc.					12,517	0	0
				Total.	2,46,380	0	0
Less Expenses :	Rs.	A.	P.				
Guaranteed Interest.	1,34,121	0	0				
Other interest and expenses	61,885	0	0		1,96,006	0	0
Balance being net receipts from shareholders (the figure shown alone in this paragraph).					50,374	0	0
Add. Sums carried to Bad-debt Reserve, Provident Fund Reserve, depreciation on buildings, furniture, etc.	12,057	0	0				
Less. Depreciation admissible under the rules.	1,127	0	0		10,930	0	0
Total profits received from shareholders.					61,304	0	0

Before the Income-tax Officer had completed the assessment for 1932-33, the Court decided the case of the Madras Hindu Permanent Fund. This decision was interpreted to mean that companies such as this were earning profits by lending money to their own members and that in the computation of such profits the guaranteed interest paid to the members must be deducted. The Income-tax Officer therefore held that the principle of the decision in the Mylapore Fund Case was no longer applicable to the petitioner Fund and that its entire net profits, subject to the deduction aforesaid, were liable to assessment. He accordingly assessed the Fund on a total income computed at Rs. 74,888 as shown below :—

Interest on securities.				7,790	0	0
Property.				737	0	0
Business : Profit from shareholders	61,304	0	0			
Profit from non-shareholders, Bank interest, rent and commission, items (2) and (4) above.	1,401	0	0	62,705	0	0
Discount on Treasury bills.				3,656	0	0
Total income				74,888	0	0

The Income-tax Officer levied tax amounting to Rs. 13,302-2-0

8. The Fund appealed to the Assistant Commissioner. There was no dispute regarding the figures. The only objection was that Rs. 61,304 being the income derived by the Fund from dealings with its own shareholders was not liable to assessment. The Assistant Commissioner examined in detail the Fund's objection and came to the conclusion that the petitioner Fund was carrying on banking business with its shareholders and that the excess of receipts over expenses was business profit liable to assessment. He accordingly confirmed the assessment and dismissed the appeal. A copy of his order is filed marked Exhibit D.

9. The petitioner Fund now requires me to refer to the High Court the following questions of law said to arise out of the Assistant Commissioner's order :—

(1) Whether the petitioner's case is not directly governed by the decision in the Mylapore Fund Case and the income in question is not therefore taxable income.

(2) Whether the decision in the Madura Fund Case in any way conflicts with the decision in the Mylapore Fund Case and makes the latter decision inapplicable to a mutual benefit concern as the petitioner Fund.

10. The real question that arises in this case is :—" Whether Rs. 61,304 being the income of the petitioner Fund derived from the transactions with its shareholders is liable to assessment." I accordingly refer this question for their Lordships' opinion.

11. In my opinion the petitioner Fund is a company carrying on a trade. It is not any the less a trader because its customers, the persons to whom it lends money, happen to be its own shareholders. Profits resulting from a trade are liable to tax unless specifically exempted, and there is no question of any such exemption here. I consider therefore that the sum in question is liable to the tax.

It was held in the case of the *New York Life Insurance Co. v. Styles* (2 Tax. Cas. 460) that for the purposes of that case the fact that the company was incorporated might be ignored. This Court has held in deciding the case of the *Madura Hindu Permanent Fund Ltd.*, that the facts of that case, to which this is similar, were different from those in the *New York Life Insurance Company* v. *Styles*. That incorporation cannot always be ignored is apparent from several English decisions, notably that in *Liverpool Corn Trade Association* v. *Monks* (10 Tax. Cas. 442).

12. I am reluctant to trouble their Lordships again with this question, which in substance has been before them in several previous cases, particularly those of the *Mylapore Hindu Permanent Fund, the Madura Hindu Permanent Fund*, and *the Sivaganga Sri Minakshi Swadeshi Saswatha Nidhi*. But I feel compelled to do so because the combined effect of these previous decisions is not very clear to me. As has been stated above, the assessment now in dispute was made in accordance with the decisions of this Court (as then interpreted) in the case of the *Madura Hindu Permanent Fund Ltd.* An assessment on similar lines was made on the *Sivaganga Sri Minakshi Swadeshi Saswatha Nidhi* but the decision of their Lordships on that assessment (O.P. 197 of 1933) was that the *Mylapore Hindu Permanent Fund case* ought to have been followed. Even the *Madura Hindu Permanent Fund* now claims that the decision arrived at in its own case after a protracted litigation is not applicable but that the *Mylapore Hindu Permanent Fund Case* should govern its subsequent assessments. The present position therefore cannot be said to be clear. The question now raised is of great public importance since its decision affects a large number of similar Funds. It appears necessary therefore to trouble their Lordships with this further reference. The alternative of preferring an appeal to His Majesty in Council against the judgment of this Court in the case of the Sivaganga Sri Minakshi Swadeshi Saswatha Nidhi could not be considered because (as the figures in the case will show) that Fund could ill afford the expense of contesting an appeal.

S. Srinivasa Aiyangar with *K. Rajah Aiyar*, and *V. Ramaswami Iyer*, for the Assessees.

M. Patanjali Sastri for the Commissioner.

JUDGMENT.

The Commissioner of Income tax has referred for the opinion of the High Court the question whether the sum of Rs. 61,304 being the income or the profits of the Fund derived from the transactions with the shareholders is liable to assessment.

The petitioner is the Tanjore Permanent Fund Limited. It is a company incorporated in 1901 under the Indian Companies Act, VI of 1882, now Act VII of 1913. The company started with 2,222 shares of Rs. 45 each share and a nominal capital of Rs. 99,990. The amount of each share is payable in monthly instalments of Re. 1. The share account of each shareholder is

closed on the expiry of 45 months from the last date of the month in which he was admitted by his being paid Rs. 50 and then he ceases to be a shareholder. The difference between the amount subscribed by him and the amount paid to him at the end of the 45th month, *viz.*, Rs. 5, is called "guaranteed interest." The Fund accepts deposits from its shareholders on which interest is allowed to them. The Directors are authorised temporarily to borrow from time to time, if necessary, sums to carry on its transactions. The collections of the Fund are used to be lent to the shareholders at specified rates of interest on the security of the share held by them and also on their other properties. The moneys belonging to the Fund may be invested by the Directors with banks or Co-operative Societies or in Government securities, Treasury bills or Post Office Cash Certificates. The Fund does not accept deposits from other persons than its shareholders, nor does it give loans to outsiders.

The Fund's main source of income is the interest on the loans advanced to the shareholders. It also derives income from interest on the deposits with banks, interest on securities, house rent and other minor items. The excess of interest earned by the Fund over the expenses of the institution and the interest earned by the shareholders is regarded as profits of the Fund out of which 70 per cent. is divided among the shareholders and the balance after paying the legal adviser, remuneration and bonus to the establishment is carried to the reserve fund.

The number of shareholders of the Fund and the amount of shares fluctuate from time to time. On the 15th August 1931 as mentioned by the Commissioner, there were on the register of the Fund 9,984 shareholders with 1,10,740 shares and the subscribed capital of Rs. 49,83,300.

For the assessment of the year 1932-33 the Fund returned an income amounting to Rs. 14,178. In submitting this account it did not include as assessable income a sum of Rs. 61,304, the profits derived from the shareholders. The question referred to us is whether income tax can be levied on this amount.

A case exactly like the present one was decided in *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd.*, in which it was held that a fund like this was a mutual benefit society and therefore the receipts from shareholders were not income liable to assessment under the Act. The Income tax Officer did not follow this decision as before he completed the assessment this Court decided the case of the *Madura Hindu Permanent Fund*,

That decision was interpreted by him to mean that profits earned by the Fund by lending money may be taxed. He therefore held that the decision in *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund., Ltd.*, was no longer applicable and assessed the Fund on the total income including the profits of Rs. 61,304. The Assistant Commissioner confirmed the order of the Income tax Officer. The Commissioner referring the case to us says that the combined effect of these two decisions and of the decision of this Court in *Sivaganga Sri Meenakshi Nidhi* v. *Commissioner of Income Tax, Madras*, is not very clear to him. He also argues that the petitioner Fund is a company carrying on a trade and as such that the fact that it carries on the trade with its own customers does not make it any the less a trader and that the profits resulting from the trade are liable to tax unless specially exempted and as there is no question of any such exemption here the amount of profits earned, *viz.*, Rs. 61,304 is assessable to tax.

At the outset we may observe that so far as the decisions of this Court are concerned, there is no conflict amongst them. The decision in *Madura Hindu Permanent Fund Ltd. v. Commissioner of Income Tax, Madras*, followed by the Income tax Officer does not touch the question of the liability to assessment of the profits earned by the Fund from its shareholders nor does it, in our opinion shake the authority of the decision in *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd.* In the first case, *Madura Hindu Permanent Fund Ltd.* v. *Commissioner of Income Tax, Madras*, the question was whether the "guaranteed interest" may be deducted from the total income of the Fund during the year of account. This Court held that the guaranteed interest was interest on capital borrowed for the purpose of the fund's business within the meaning of section 10 (ii) (3) of the Income tax Act, that its payment was not in any way dependent on the earning of the profits and that the fund was entitled to claim deduction in respect of that sum distributed by it as guaranteed interest. The question now referred to us did not arise for decision in that case. In the *Sivaganga Minakshi Nidhi Case* this Court pointed out that that case was one like *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund, Ltd.*

It is conceded by the learned counsel for the Commissioner that on the facts this case would fall exactly within the scope of the decision in *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd.* What he wants to argue is that that case was wrongly decided and that he should be allowed to reopen the

question. So far as this Court is concerned, the question has been considered and decided by the Full Bench in *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd.* As pointed out in *Madura Hindu Permanent Fund Ltd.* v. *Commissioner of Income tax, Madras*, the Fund though registered under the Indian Companies Act and subject to its provisions is not really a company but a mutual benefit society with a fluctuating capital. The subscriptions though called share capital are not really so, nor are they capital borrowed for the purpose of the business as that capital is ordinarily understood. In enacting the explanation to Sec. 10 (ii) (3) Income-tax Act it would seem that the legislature has shown its intention to recognise the existence of such mutual benefit societieties like the one in question.

As the law on the point has been clearly laid down in *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd.* and as this case falls exactly within its scope we are not inclined now to reopen the question and to disturb the practice which has been followed since *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd.*, whatever view we may be inclined to take if the point was *res integra.* Though the term "shareholder" has been here used, we do not wish to be understood as deciding that these subscribers are shareholders properly so called within the meaning of the Companies Act. The matter is not before us.

Our answer to the question accordingly is that the sum of Rs. 61,304 is, in the circumstances of the case, not liable to assessment. The assessee is entitled to Rs. 250 for costs and will get a refund of the Rs. 100 deposit.

Question answered accordingly.

[IN THE PRIVY COUNCIL.]

COMMISSIONER OF INCOME TAX, CENTRAL AND UNITED PROVINCES *v.* LAXMINARAIN BADRIDAS.

LORD RUSSELL OF KILLOWEN, LORD MACMILLAN and SIR JOHN WALLIS.

February 19, 1937.

BEST JUDGMENT ASSESSMENT—GUIDING PRINCIPLES—HOW FAR DISCRETIONARY—NATURE AND FINALTY OF SUCH ASSESSMENT—LOCAL INQUIRY, WHETHER NECESSARY—CANCELLATION—SUFFICIENCY OF CAUSE—REFERENCE—QUESTION OF FACT—ADJOURNMENT—RESPECTIVE DUTIES OF ASSESSEES AND INCOME TAX OFFICERS—INDIAN INCOME TAX ACT (XI OF 1922), SS. 23 (4), 27, 33, 66 (2).

Under S. 23 (4) of the Income Tax Act the officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by, and assessments of, the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily, be guess-work in the matter, it must be, honest guess-work. In that sense too the assessment must be, to some extent, arbitrary. The section places the officer in the position of a person whose decision as to amount is final and subject to no appeal, but whose decision, if it can be shown to have been arrived at without an honest exercise of judgment, may be revised or reviewed by the Commissioner under the powers conferred upon that official by S. 33.

The language of the Act does not justify the laying down of rules imposing upon the officer the duty of (i) *conducting some kind of local inquiry before making the assessment under S. 23 (4) and* (ii) *recording a note of the details and results of such inquiry, and there is no justification for holding that an assessment made by an officer under S. 23 (4) without conducting a local inquiry*

and without recording the details and results of that inquiry cannot have been made to the best of his judgment within the meaning of the section. Krishna Kumar *v.* Commissioner of Income Tax *explained,* Abdul Bari Chowdhury *v.* Commissioner of Income Tax *approved.*

Under S. 23 (4) the fact of failure to comply with the notice under S. 22 (4) makes it compulsory on the officer to make an assessment; and under S. 27 unless the officer is satisfied that the assessee had not a reasonable opportunity to comply or was prevented by sufficient cause from complying with that notice, the assessment must stand. That he had sufficient cause for not complying with another notice is irrelevant.

There is no rule by which the officer is bound or ought to announce beforehand how he proposes to deal with an application for an adjournment. Where the assessee had already obtained one adjournment it is his duty if he desired a further adjournment, to apply at a date sufficiently early to enable him, in the case of a refusal, to be prepared to proceed on the appointed day and the fact that the officer proceeded to assessment "to the best of his judgment" will not constitute a wrongful exercise of a judicial discretion on the ground that (1) no previous intimation had been given of the intention of the officer to refuse a further adjournment; and (2) that the assessee had shown sufficient cause for not complying with the notice under S. 23 (2).

It is not possible to turn a mere question of fact into a question of law by asking whether as a matter of law the officer came to a correct conclusion upon a matter of fact.

COMMISSIONER OF INCOME TAX, C.P. & U.P. *v.* LAXMINARAIN BADRIDAS [1934 I.T.R. 246] *reversed.*

ABDUL BARI CHOUDHURY *v.* COMMISSIONER OF INCOME TAX, BURMA [1931] (I.L.R. 9 Rang. 281; 113 Ind. Cas. 81; A.I.R. 1931 Rang. 194; 5 I.T.C. 352) *approved.*

KRISHNAKUMAR *v.* COMMISSIONER OF INCOME TAX [1931] (5 I.T.C. 296) *explained.*

Appeal from the judgment of the Judicial Commissioner's Court of Central Provinces in a case stated by the Commissioner of Income Tax, C.P., under Sec. 66 (2) of the Indian Income Tax Act. The Judgment is reported at pp. 246 ff. of Vol. II of the *Income Tax Reports.*

Wallach, for the Appellant.

JUDGMENT.

LORD RUSSELL OF KILLOWEN—In this case the Commissioner of Income Tax for the United and Central Provinces appeals from a judgment of the Court of the Judicial Commissioner, Central Provinces, on a reference under S. 66 (2) of the Indian Income Tax Act (XI of 1922). The respondent taxpayer did not appear on the hearing of the appeal.

The case relates to an assessment made by the Income Tax Officer under S. 23 (4) of the Act, subsequently to an alleged failure by the taxpayer to comply with all the terms of a notice issued under S. 22 (4) of the Act. It will be convenient before stating the facts of the case to set out the provisions of the Act (as amended by the Indian Income Tax (Amendment) Act, 1930, and the Indian Income Tax (Second Amendment) Act, 1930, which are relevant, and under which the various steps in the case, leading up to the reference, were taken. They are the following :—

"22. (1)... ...

(2) In the case of any person other than a company whose total income is, in the Income Tax Officer's opinion, of such an amount as to render such person liable to income-tax, the Income Tax Officer shall serve a notice upon him requiring him to furnish, within such period not being less than thirty days as may be specified in the notice, a return in the prescribed from and verified in the prescribed manner setting forth (along with such other particulars as may be provided for in the notice) his total income during the previous year.

(3) If any person has not furnished a return within the time allowed by or under sub-S. (1) or sub-S (2), or having furnished a return under either of those sub-sections, discovers any omission or wrong statement therein, he may furnish a return or a revised return, as the case may be, at any time before the assessment is made, and any return so made shall be deemed to be a return made in due time under this section.

(4) The Income Tax Officer may serve on the principal officer of any company or on any person upon whom a notice has been served under sub-S. (2) a notice requiring him, on a date to be therein specified to produce, or cause to be produced, such accounts or documents as the Income tax Officer may require :

Provided that the Income Tax Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

23. (1) If the Income-tax Officer is satisfied that a return made under Sec. 22 is correct and complete, he shall assess the total income of the assessee, and shall determine the sum payable by him on the basis of such return.

(2) If the Income-tax Officer has reason to believe that a return made under Sec. 22 is incorrect or incomplete, he shall serve on the person who made the return a notice requiring him, on a date to be therein specified, either to attend at the Income-tax Officer's office or to produce, or cause to be there produced, any evidence on which such person may rely in support of the return.

(3) On the day specified in the notice issued under sub-Sec. (2), or as soon afterwards as may be, the Income-tax Officer, after hearing such evidence as such person may produce and such other evidence as the Income-tax Officer may require, on specified points, shall, by an order in writing, assess the total income of the assessee, and determine the sum payable by him on the basis of such assessment.

(4) If the principal officer of any company or any other person fails to make a return under sub-Sec. (1) or sub-Sec. (2) of Sec. 22, as the case may be, or fails to company with all the terms of a notice issued under sub-Sec. (4) of the same section or, having made a return, fails to comply with all the terms of a notice issued under sub-Sec. (2) of this section, the Income-tax Officer shall make the assessment to the best of his judgment and, in the case of a registered firm, may cancel its registration.

Provided "...........

"27. Where an assessee or, in the case of a company, the principal officer thereof, within one month from the service of a notice of demand issued as hereinafter provided, satisfies the Income-tax Officer that he was prevented by sufficient cause from making the return required by S. 22, or that he did not receive the notice issued under sub-S. (4) of S. 22, or Sub-S. (2) of S. 23, or that he had not a reasonable opportunity to comply, or was prevented by sufficient cause from complying, with the terms of the last mentioned notices, the Income-tax Officer shall cancel the assessment and proceed to make a fresh assessment in accordance with the provisions of S. 23".

"30. (1) Any assessee objecting to the amount or rate at which he is assessed under S. 23 or S. 27, or denying his liability to be assessed under this Act, or objecting to a refusal of an Income-tax Officer to make a fresh assessment under S. 27, or to any order against him under sub-S. (2) of S. 25 or S. 25-A or S. 28

made by an Income-tax Officer, may appeal to the Assistant Commissioner against the assessment or against such refusal or order: Provided that no appeal shall lie in respect of an assessment made under sub-S. (4) of S. 23, or under that sub-section read with S. 27.

(2)......

(3)......

31. (1) ...

"(2) The Assistant Commissioner may, before disposing of any appeal, make such further inquiry as he thinks fit, or cause further inquiry to be made by the Income-tax Officer.

(3) In disposing of an appeal the Assistant Commissioner may, in the case of an order of assessment,—

"(*a*) confirm, reduce, enhance or annul the assessment, or

"(*b*) set aside the assessment and direct the Income-tax Officer to make a fresh assessment after making such further inquiry as the Income-tax Officer thinks fit or the Assistant Commissioner may direct, and the Income-tax officer shall thereupon proceed to make such fresh assessment......

"(*c*)......

"(*d*)......

"Provided......

"33.—(1) The Commissioner may of his own motion call for the record of any proceeding under this Act which has been taken by any authority subordinate to him or by himself when exercising the power of an Assistant Commissioner under sub-s. (4) of S. 5.

"(2) On reeeipt of the record, the Commissioner may make such inquiry or cause such inquiry to be made, and, subject to to the provisions of this Act, may pass such orders thereon as he thinks fit:

"Provided that he shall not pass any order prejudicial to an assessee without hearing him or giving him a reasonable opportunity of being heard."

The respondent having been served on April 29, 1931, with a notice under S. 22 (2), furnished a return, dated July 27, 1931, which consisted of a printed return form, and contained but two statements only, *viz.*, (*a*) opposite the paragraph relating to business the words and figures "Rs. 1,700. Approximate amount of loss" and (*b*) in the place where should appear the total amount of profit and gains or income, the same words and figures.

A return in such a form was obviously unsatisfactory and incomplete. The officer thereupon served upon the respondent on September 8, 1931, a combined notice requiring the respondent [under S. 22 (4)] to "produce or cause to be produced at my office" his accounts for three years and [under S. 23 (2)] either to attend or to produce or cause to be produced any evidence on which he might rely in support of his return. The date specified was September 14, 1931. On September 12, 1931, he applied for and obtained an adjournment until October 19, 1931, for which date a fresh combined notice was issued and served on September 23, 1931.

On October 19, 1931, the respondent applied in writing for a further adjournment alleging that he had been ill for the last month and could do no work; and that his agent, who had been away, had returned. With this application he seems to have sent a medical certificate, which however, merely stated that the respondent "was suffering from influenza some fifteen days ago," that he had gone very weak since that time and that he was still weak and suffering from a cough.

Their Lordships are not surprised that the officer was unable to accept such a certificate, and refused to grant any further adjournment. There would appear to be ample ground for his view that the application, backed by such a certificate, was merely a device to obtain a postponement. No accounts were produced or caused to be produced by the respondent, and the officer proceeded as enjoined to do by S. 23 (4) to make the assessment to the best of his judgment. No accounts being available he took into consideration the local repute that the respondent's money-lending business was extensive, and included the purchasing of debts at large profit to himself, and that he was easily the richest man in the District. Further, as stated in the assessment note, "local inquiries" had shown that his fluid resources amounted to ten lacs. The officer estimated the respondent's income at one lac.

From an assessment made under S. 23 (4) there is no appeal; but the assessee may endeavour to satisfy the officer as to the relevant question of fact specified in S. 27, and if he succeeds, the officer must cancel the assessment and make a fresh assessment in accordance with the provisions of S. 23. The respondent applied for cancellation under S. 23. His application was heard (with witnesses) in December 1931, by the Income-tax Officer then in office. He refused the application. The only excuse alleged by the respondent for his failure to comply with the notice relating

to the production of accounts was that he could not attend to produce them in person. As he could have caused them to be produced by sending them by messenger, he failed to satisfy the officer as required by S. 27.

From this refusal the respondent (as entitled under S. 30) appealed to the Assistant Commissioner. His appeal was heard on February 27, 1932, and was rejected on the ground that he had not been able to show that he had sufficient cause for withholding the accounts on October 19, 1931. The assessment was accordingly confirmed by order made under S. 31.

Down to this point in the history of this matter it appears to their Lordships that the provisions of the Act had been strictly complied with by the income-tax officials. No further appeal lay open to the respondent, but it was no doubt to the Commissioner to exercise the powers of revision or review contained in S. 33.

The respondent, however, applied to the Commissioner for a reference under S. 66 (2) of the Act. The relevant provision of that sub-section runs thus:—

"Within sixty days of the date on which he is served with notice of an order under S. 31......the assessee......may......require the Commissioner to refer to the High Court any question of law arising out of such order......and the Commmissioner shall ....draw up a statement of the case and refer it with his own opinion thereon to the High Court."

The Commissioner, however, may (sub-section 3) refuse to state the case on the ground that no question of law arises.

The respondent asked to have referred seven alleged points of law. They were formulated thus:—

(*i*) Whether the Income-tax Officer was justified in assuming jurisdiction to proceed under S. 23 (4) of the Income Tax Act and making *ex parte* assessment in this case when there is no legal evidence to show that the assessee deliberately failed to comply with the notice issued under S. 22 (4) of the Income-tax Act.

(*ii*) Whether the circumstances alleged and proved by the assessee could not, in law, be deemed to be 'sufficient cause' under S. 27 of the Income Tax Act.

(*iii*) In view of the wording of the notice under S. 22 (*a*) (*sic*) of the Act and the undisputed fact that the assessee was too ill to attend the Court and the further admitted fact that the Income-tax Officer did not pass or communicate to the assessee's servant

or to the assessee any order for immediate production of account books or any other fair order, could not the assessee under law claim cancellation of the *ex parte* assessment order, dated October 19, 1931.

(*iv*) Whether the procedure adopted by the Income-tax Officer in causing notices to be served under Ss. 23 (2) and 22 (4) of the Income Tax Act was legal and proper and whether the Income Tax Officer could, under the circumstances, proceed under S. 23 (4) and make *ex parte* assessment.

(*v*) Is there evidence to substantiate the Income Tax Officer's reasoning in the last paragraph of the order saying that legal enquiries prove that the assessee made in the account year taxable income of a *lakh* of rupees.

(*vi*) Is not the judgment of the Income Tax Officer vitiated by imaginary assumptions or irregular enquiries and hearsay evidence which the assessee has no chance to meet and which are not borne out by his account books which the Income Tax Officer could have called for.

(*vii*) Is the order of assessment passed by the Income Tax Officer to the best of his judgment in view of the arbitrary reasons he has given and despite the notorious trade depression and financial strain all along."

The Commissioner in the case which he stated, stated his opinion upon the seven points as follows :—As to (*i*) the assessee on the evidence could have sent the accounts even if (which the medical evidence did not establish) he could not bring them himself. He had not, therefore, complied with the terms of the notice under S. 22 (1); and the point should be answered against the assessee. As to (*ii*) the question was one of fact and not of law, and could not be referred to the High Court. As to (*iii*) the reference to S. 22 (*a*) was admitted to be intended as a reference to S. 22 (4), and as the accounts could have been produced by some one on the assesses's behalf, that point should be answered against the respondent. As to (*iv*) if it meant that because a notice was served under S. 23 (2) a notice under S. 22 (4) was illegal, and that non-compliance with an illegal notice would not authorise an assessment under S. 23 (4), the point was covered by a recent decision by the Full Bench of the Lahore High Court which was adverse to the respondent's contention. As to (*v*) no evidence was necessary. The officer had merely to estimate as best he might the income for purposes of assessment. If any reasons were given as in the present case, it was merely to show that the estimate

was not arbitrary. As to (*vi*) and (*vii*) in view of his opinion as to (*v*) there was no occasion to answer these.

The reference was heard in the Court of the Judicial Commissioner, Central Provinces (which was a High Court for the purposes of S. 66) by a Judicial Commissioner and an Assistant Judicial Commissioner. They held, in reference to points (*i*) and (*iv*), that the notice was legal and that the officer had jurisdiction to make the summary assessment under S. 23 (4); but they thought that the omission to make and communicate to the respondent a definite order refusing an adjournment did " considerably detract from the technical legality of the summary assessment order." They answered these points in the affirmative, *i.e.*, against the respondent. In regard to points (*ii*) and (*iii*) they considered whether the findings of the officer and the Assistant Commissioner that the respondent " had not shown sufficient cause for re-opening the *ex parte* assessment satisfies the test that it was arrived at after the exercise of judicial discretion." They held that several relevant facts had been left out of consideration, *viz.*: (1) that if the respondent's Court agent had been informed that no adjournment would be granted because the account books should have been sent with the *Munim*, it was possible that the notice for production might have been complied with; (2) that the failure by the officer in observing this elementary rule" had contributed to the non-compliance with the terms of the notice; and (3) that the respondent desired to testify in person to the accuracy of the account books. On the finding that the respondent could not by reason of illness himself attend the Court on the appointed day, they were of opinion that the only reasonable finding which should have been recorded was that the respondent had shown sufficient cause for non-compliance with the terms of the notice under S. 23 (2) [*i.e.*, the notice as to evidence, not the notice as to producing accounts], and that it followed that he had clearly made out sufficient cause for re-opening the assessment, and that the officer and Assistant Commissioner had failed to exercise their discretion on reasonable and proper grounds.

They then proceeded to consider points (*v*), (*vi*) and (*vii*); and held as a result of an examination of certain authorities that no assessment would be an assessment by the officer ' to the best of his judgment" within the meaning of S. 23 (4) unless (1) a local inquiry to ascertain the income for the previous year of the proposed assessee was first held, and (2) the officer placed " on the

record a note of the details and results of his inquiry". They held that the present assessment rested merely on the caprice of the officer and was not made "to the best of his judgment" within the meaning of S. 23 (4). They answered point (*v*) in the negative, point (*vi*) in the affirmative, and point (*vii*) in the negative.

Their Lordships find themselves in disagreement with this decision, except in so far as it answered points (*i*) and (*iv*) in the affirmative, and decided that the officer was in the events which had happened entitled to proceed to make an *ex parte* assessment under S. 23 (4). If the assessment in this case was made by the officer to the best of his judgment, it must stand unless the assessee succeeded in satisfying the officer that he had not a reasonable opportunity to comply or was prevented by sufficient cause from complying with the terms of the notice under S. 22 (4) requiring him to produce or cause to be produced his accounts for three years. This he failed to do, and upon the undisputed and indisputable facts of the case he necessarily so failed. His application under S. 27 for cancellation of the assessment was doomed to failure, and his appeal to the Assistant Commissioner under S. 30 was equally incapable of success. There the matters should have ended, unless the Commissioner chose to proceed under S. 33. The questions involved were purely questions of fact, indeed one might say of self-evident fact, and no reference in regard thereto should have been made under S. 66 (2). No question of law was involved: nor is it possible to turn a mere question of fact into a question of law by asking whether as a matter of law the officer came to a correct conclusion upon a matter of fact. The Judicial Commissioners have treated the matter as a wrongful exercise of a judicial discretion, the foundation for the allegation of wrongful conduct being the facts that (1) no previous intimation had been given of the intention of the officer to refuse a further adjournment on October 19, 1931, which they characterised as a failure to observe an elementary rule; and (2) that the respondent had shown sufficient cause for not complying with the notice under S. 23 (2).

Their Lordships are unable to appreciate this reasoning. This does not appear to be a case of exercising a discretion. Under S. 23 (4) the fact of failure to comply with the notice under S. 22 (4) made it compulsory on the officer to make an assessment, and under S. 27 unless the officer is satisfied (and he was not, nor on the facts of this case, could he have been) that the respondent had not a reasonable opportunity to comply or was prevented by sufficient

cause from complying with that notice, the assessment must stand. That he had sufficient cause for not complying with another notice is irrelevant. And their Lordships are unaware of any rule by which the officer was bound or ought to announce beforehand, how he proposes to deal with an application for an adjournment. The respondent had already obtained one adjournment from September 14, 1931, until October 19, 1931. It was his duty if he desired a further adjournment to apply at a date sufficiently early to enable him, in the case of a refusal, to be prepared to proceed on the appointed day. In fact the respondent delayed his application for a further adjournment until the very day appointed for compliance with the order. Even if this could be said to be a case of exercising a judicial discretion, their Lordships can see no ground on the facts of this case for suggesting that it was wrongfully exercised.

There remains for consideration the point whether the assessment can be attacked on the ground that it was not made by the officer to the best of his judgment within the meaning of S. 27. The Judicial Commissioners have laid down two rules which impose upon the officer the duty of (*i*) conducting some kind of local inquiry before making the assessment under S. 23 (4) and (*ii*) recording a notice of the details and results of such inquiry.

Their Lordships find it impossible to extract these requirements from the language of the Act, which after all is, in such matters, the primary and safest guide. The officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the matter, it must be honest guess-work. In that sense, too, the assessment must be to some extent arbitrary. Their Lordships think that the section places the officer in the position of a person whose decision as to amount is final and subject to no appeal, but whose decision if it can be shown to have been arrived at without an honest exercise

of judgment, may be revised or reviewed by the Commissioner under the powers conferred upon that official by s. 33.

Their Lordships can find no justification in the language of the Act for holding that an assessment made by an officer under S. 23 (4) without conducting a local inquiry and without recording the details and results of that inquiry cannot have been made to the best of his judgment within the meaning of the section. Nor can they find any such justification in the authorities upon which the Judicial Commissioners appear to have relied.

The case of *Krishna Kumar* v. *Commissioner of Income-tax* seems to be the foundation of their two "rules." The question referred for decision in that case was in the following words:— "The Income-tax Officer simply puts 'Business. Rs. 30,000.' No basis or details are apparent. Can this be an assessment to the best of one's judgment?" The Court simply answered "yes." This, as a decision, does not seem to afford any basis for the rules. But the Judicial Commissioners refer to the fact that the Commissioner stated in his case that the officer had made a local inquiry and had recorded a note of the details and results of his inquiry, and say that "it is apparent that the answer would have been in the negative if the Income-tax Officer had made no local inquiry and not placed a detailed note thereof on the record in support of the assessment."

Their Lordships can find no justification for attributing this view to the High Court in that case. Indeed the Judicial Commissioners in the present case seem to treat the matter as decided not by the view of the High Court but rather by the opinion of the Commissioner for Income-tax; for they use the following language:

"While the aforesaid remarks of the Commissioner of Income-tax, Bengal, impliedly concede that 'local enquiry' and the placing on record of a note of the results of such enquiry are essential in law to sustain an *ex parte* assessment the learned Commissioner of Income-tax of these provinces thinks otherwise, presumably on certain observation in *Abdul Bari Chowdhury* v. *Commissioner of Income-tax, Burma*, which go so far as to lay down that an *ex parte* assessment may as well be made on 'mere guess' of the Income-tax Officer who is the *persona designata* to make the 'assessment' and against whose order 'no appeal lies'. With due deference we hesitate to subscribe to such a widely stated proposition as it is extremely likely to lead to certain abuse of the powers by the Income-tax Officers in the discharge of their duties

which must be performed throughout in conformity with the rules of justice, equity and good conscience."

The other authorities cited by the Judicial Commissioners do no more, their Lordships think, than affirm that the officer must exercise judgment and must not act on mere caprice, or in any other way inconsistent with the exercise of judgment.

Their Lordships find themselves in agreement with the views expressed by the High Court at Rangoon in the case of *Abdul Bari Chowdhury* v. *Commissioner of Income-tax, Burma.*

Their Lordships are of opinion that the assessment must stand and that on the reference points (*ii*) (*iii*) and (*vi*) should (if answered at all), have been answered in the negative and points (*v*) and (*vii*) should (if answered at all) have been answered in the affirmative, and the respondent should have been ordered to pay the costs of the reference. This appeal should succeed and the order under appeal should be amended as indicated above and their Lordships will humby advise His Majesty accordingly. The respondent will pay the costs of the appeal.

Appeal allowed.

[IN THE CALCUTTA HIGH COURT.]

Mersrs. HOOSEN KASAM DADA, (a firm)

v.

COMMISSIONER OF INCOME-TAX, BENGAL.

Mr. Justice COSTELLO and Mr. Justice PANCKRIDGE.

January 25, 1937.

FIRM—PARTNERSHIP WITH *Wakf*—VALIDITY—APPLICATION FOR REGISTRATION AS FIRM—MAINTAINABILITY—NATURE OF *Wakfs*—WHETHER REMAINING PARTNERS CAN BE REGISTERED AS FIRM—POWER OF INCOME-TAX OFFICER TO ENQUIRE INTO REALITY OF FIRM—INDIAN INCOME-TAX ACT (XI OF 1922), SEC. 26-A—INCOME TAX RULES, RR. 3, 4.

Under the Mahomedan law, the moment a wakf *is created all rights of property pass out of the* wakf *and vest in the Almighty, and as a non-personal being, such as the Almighty is, cannot enter*

into a partnership with material persons, a partnership which purports to exist with a wakf *represented by the* mutawalli *as a partner, is no partnership in law and cannot be registered as a firm under Sec. 26-A of the Indian Income-tax Act. Further, a man cannot at one and the same time be a partner in his individual capacity and a partner in his representative capacity.*

Under S. 26-A of the Income-tax Act and Rules 3 and 4 of the Rules framed under the Act, the Income-tax officer is only empowered to register the partnership which is specified in the instrument of partnership which has been put forward. Therefore, where mutawallis *of* wakfs *or infants are partners to the firm which is sought to be registered, the partnership cannot be treated as one between the remaining partners and registered as such under Sec. 26-A; nor can the* wakf *or the infant partners be treated as partners in a loose sense in such cases and the partnership be considered as one that could be registered under Sec. 26-A.*

Where an application is made for registration of a firm the Income tax officer has power to determine whether the partnership which is alleged to exist really exists, and to refuse registration if it does not exist.

Cases referred to:

ABDUR RAHIM *v.* NARAYAN DAS AURORA [1922] (50 I.A. 84; 28 C.W.N. 121).

BISSESWAR LAL BRIJ LAL, *In re* [1930] (I. L. R. 57 Cal. 1338; 34 C.W.N. 363; A.I.R. 1930 Cal. 449; 128 I.C. 327; 4 I.T.C. 365).

JEWAN SHAH SAHU *v.* SHAH KUBBEERUDDIN [1840] (2 M.I.A. 390).

VIDYAVARUTHI THIRTHA SWAMI *v.* BALUSAMI IYER [1928] (48 I.A. 302; 26 C.W.N. 537).

Case stated by the Commissioner of Income-tax, Bengal, under Sec. 66 (2) of the Indian Income-tax Act [Civil Ref. No. 1 of 1936] and Application under Sec. 66 (3) of the Indian Income Tax Act to require the Commissioner of Income-tax, Bengal, to state certain questions of law to the High Court [Civil Ref. No. 5 of 1936] in the matter of the assessment of Messrs. Hoosen Kasam Dada, a firm, in respect of the year 1933-34.

STATEMENT OF CASE.

At the request of the applicant named above (hereinafter referred to as the assessee) a case is stated for the decision of Their Lordships, the Hon'ble Judges of the Calcutta High Court, on the questions of law formulated in paragraph 7 below.

2. The matter at issue arises out of an assessment made for the year 1933-34 on the assessee as an unregistered firm and on a total income of Rs. 2.87,846 as against an income of Rs. 1,60,854 returned by the assessee.

3. During the pendency of the assessment proceedings the assessee submitted an application under Section 2 (14) of the Act, dated 23rd November 1933, praying for registration of the firm in accordance with the particulars contained in an Instrument of Partnership dated 22nd October 1933. As the assessee, however, was doubtful regarding the validity of that partnership deed, he later executed a fresh Instrument of Partnership dated 25th March 1934 (copy appended and marked A) and on the 10th May 1934 filed a fresh application under Section 2 (14) of the Act read with Section 26-A for registration of the firm in accordance with the terms of this partnership deed (copy of this fresh application appended marked B). Assessee's claim for registration is now entirely based on this new deed of partnership, his case being that the constitution of the firm at the relevant date was governed by this instrument. This instrument of partnership purports to be between twenty parties of which parties of the 17th, 18th, 19th, and 20th parts are minors represented by Hossen Kasam the first part. According to clause 4 of that fresh partnership deed, the partnership was to be deemed to have come into force from the 10th July 1933 on which date new account books for the business were opened and to remain in force for one year terminating on or about the 9th July 1934 unless extended by mutual consent of all the partners. The table which I give immediately below shows the names of the partners, their shares as representing capital, labour or goodwill or a combination of these, the rupee value of these shares and the total shares held by each according to this deed of partnership dated 25th March 1934.

Share for Capital.	Sum of Rupees.	Share for the name.	Share for the labour.	Total shares.	Name of the shares
185	4,44,000	75	...	260	Hoosen Kasam Dada
48	1,15,200	...	75	123	Abdarehman Kasam
45	1,08,000	...	68	113	Valimohamed Kasem
7	16,800	...	...	7	Adam Ayib Mamed
5¼	12,600	...	14	19¼	Karim Ayib Mamed
2¾	6,600	...	14	16¾	Umer Ayib Mamed
23	55,200	...	...	23	Hoosen Kasam, Manager of Grant & Dharmay Wakf Fund
8¾	21,000	...	26	34¾	Ahmed Haji Oosman
157	3,76,800	...	...	157	Hoosen Kasam, Manager Kasemi Fund
44	1,05,600	...	40	84	Issa Kasam
18	43,200	...	...	18	Rookiya Adam
112	2,68,800	...	36	148	Hajiadam Hoosen
112	2,68,800	...	25	137	Salchmohamed Hoosen
111	2,66,400	...	...	111	Rahemtula Hoosen
111	2,66,400	...	...	111	Ismail Hoosen
111	2,66,400	...	...	111	Tayoob Hoosen
3	7,200	...	...	3	Minor Kasam Hoosen by his guardian Hoosen Kasam
3	7,200	...	...	3	Minor Alimamad Hoosen by his guardian Hoosen Kasam.
3	7,200	...	...	3	Minor Jusuf Hoosen by his guardian Hoosen Kasam
3	7,200	...	...	3	Minor Abdulrazak Hoosen by his guardian Hoosen Kasam

4. Hoosen Kasam Dada is the senior partner, Abdarehman, Valimohamed and Issa Kasam are his step-brothers. Adam Ayib, Karim Ayib, and Umer Ayib are his sister's sons, Ahmed Haji Oosman is his nephew, Rookiya Adam is his second wife and the nine remaining, apart from two wakfs are his sons, five of them being majors and four minors. In addition there are shown in the partnership deed two trusts or wakfs one styled Kasemi Fund, which is a wakf-ul-aulad established by a deed dated the 27th January 1929, the income from which is to be distributed to his male descendants, while the other fund styled Dharmay fund

has been established for the benefit of charity by a deed dated the 28th February 1931. In addition to the deed, dated the 27th January 1929, establishing the wakf-ul-aulad there is a supplementary deed dated 8th March 1931, directing or sanctioning the investment of additional funds in this wakf. Copies of the deeds in question are appended and marked, C, D & E.

5. It is not the assessee's case that these minors supplied any labour or capital except what was transferred to their accounts by a deed of alleged gift executed by Hoosen Kasam Dada on the 16th January 1930. The capital shown against Rookya Adam, the 11th party in the instrument of partnership as also against the next five partners, the 5 major sons of Hoosen Kasam Dada, were also alleged to be the result of transfer made by that deed of the 16th January 1930. Hoosan Kasam Dada had executed this deed, dated 16th January 1930, purporting to distribute a part of his capital to his wife and 9 sons (copy appended marked F) and for facility of reference clauses 2 to 8, clause 10 and an extract from clause 14 of that deed are reproduced below :—

(2) Having arranged to give my son Haji Adam Hoosain Rs. 3,15,000 I have credited that amount to his name in my books. Besides that whatever furniture he has and whatever ornaments of his wife I have given to Haji Adam Hoosain have been given to him under the following terms :—

(3) Having arranged to give my second son Saleh Muhammad Hossain Rs. 3,18,000 I have credited that amount to his name in my books and besides that whatever furniture he has and whatever ornaments of his wife I have given to Saleh Muhammad Hossain, have been given to him under the following terms :—

(4) Having arranged to give my third son Ismail Hossain Rs. 3,18,000, I have credited this amount to his name in my books and besides that whatever furniture he has and whatever ornaments I have given to his wife has been given to Ismail Hossain under the following terms :—

(5) Having arranged to give my fourth son Rahamatullah Hossain Rs. 3,21,000 I have credited this amount to his name in my books and besides that whatever furniture he has and whatever ornaments I have given to his wife have been given to Rahamatulla Hossain on conditions stipulated below :—

(6) Having arranged to give my fifth son Tayub Hossain Rs. 3,30,000 I have credited this amount to his name in my books and besides that whatever furniture he has and whatever orna-

ments I have given to his wife have been given to Tayub Hossain on conditions stipulated below :—

(7) My sixth son minor Kassem, seventh son minor Ali Muhammad, eighth son minor Yusuf and ninth son minor Abdul Razak each is given Rs. 3,30,000 and the same amounts have been credited in my books in their respective accounts. When these minors attain majority and when they enter into matrimony their expenses will be debited to the amounts standing at their credit. Whatever furniture I have got and what will be added in my life-time will be divided equally as between these four minor sons together with those who might hereafter be born and these four minor children so long as I live will live with me and I will defray their expenses.

(8) My wife Rukia Adam Haji Ibrahim who is step-mother of sons 1 to 5 and mother of sons 6 to 9 is given Rs. 25,000 for her maintenance and her account is credited with that sum in my books. So long as I live she will live with me and I will defray her expenses. The income which will accrue on the amount of Rs. 25,000 will be credited to her capital account and whatever will thus accrue to her will be given to her after my death. She, after my demise, will out of the income arising from the sum standing at her credit maintain herself and will keep the capital intact. When she dies her funeral expenses will be defrayed out of the sum standing at her credit. The residue will be divided in equal shares as between my surviving sons and the male children of those sons who predecease her. The share of the sons of each of the predeceased son will be taken as one unit and the sum will be divided equally between his sons. The sum which will be so received will be governed by paragraph 11. Whatever ornaments she will leave will be received equally by the sons born out of her.

(10) Whatever has been given under clauses 2 to 7 to my sons will be invested in business run in my name and style but under my supervision. My sons 1 to 5 Haji Saleh Muhammad, Ismail, Rahamatullah and Tayub will be given whatever they require out of their own amount. My minor sons 6 to 9 are staying with me and are to stay so long as I am alive and whose fooding and clothing charges I am defraying. Should any of them attain majority and desire to live separate from me and should it appear that he will be able to manage himself, he will like the other sons 1 to 5 be given the amount that he will require.

* * * *

(14) If after my demise the business is continued and during its continuance if any of my heirs and successors wants to take away his share he should be handed over the amount that will be found at his credit.

* * * *

6. The Income-tax Officer refused to register the firm on the ground that the wakf of mutawali H. K. Dada as manager of the wakf could not in that capacity and in the circumstances of this case be a partner in the firm and on the further ground that the wife of the senior partner and his nine sons were not legally partners on a true construction of the deed of partnership read with the deed of 16th January 1930 by which the senior partner purported to make certain gifts to his wife and sons. He held that the mutawali of the wakf was not a genuine partner for two reasons—firstly, because the wakf was not responsible for any loss which might be incurred by the firm, and secondly because the mutawali had not complied with the terms of the wakf deeds directing that the funds of the wakf should be invested in immovable properties and pending the purchase of immovable properties in Government securities and should not be invested in business or any commercial activities of a risky nature, while the Assistant Commissioner supported this view on the further argument that under the Mohamedan Law when a wakf has been legally constituted the owner of the property is the Supreme Being and the Supreme Being cannot be a partner in a firm.

7. In this matter the assessee has formulated 11 questions (set out as Appendix G to the statement of case). The matter at issue, however, in questions (a), (b) and (c) has, I think, been set at rest so far as this province is concerned by their Lordships' decision in the case of *Bisseswarlal Brijlal* v. *Commissioner of Income-tax, Bengal* (I. L. R. 57 Cal. 1336; 4. I. T. C. 365) and I do not therefore propose to state any case on these questions. Question (k) of that list of questions will be dealt with by me under Section 33 of the Act.

The real question that arises in this case may be formulated as below:

Question.—Whether on a correct construction of the alleged deed of gift dated the 16th January 1930 (and marked F) there was any valid transfer by gift of money under the Mahomedan Law to the donees named therein?

What is relevant for the purpose of registration of a firm under the Indian Income-tax Act is to see (i) that there is a genuine

firm, (ii) that there is an instrument of partnership for that firm, (ii) that the instrument specifies the names of the partners, and (iv) that the instrument specifies the individual shares of those partners. As the case of the assessee is that the parties to the Instrument from the 11th to the 20th part contributed to the capital of the alleged firm only as a result of the transfer or money purported to have been made to them by the deed of the gift the question whether that deed of gift really succeeded in transferring any money to them becomes pertinent as that will determine whether or not they are real partners. It is not their case that there was any gift of money to these persons independently of that deed of gift or that those persons supplied their share of the capital independently of what was purported to be done by that deed of gift. I would therefore refer the above question only to the High Court.

8. As required by Section 66 (2) of the Indian Income-tax Act I respectfully state my opinion on the questions formulated.

9. As regards this question, the answer, in my opinion, will greatly depend upon the Mahomedan Law of gift. In the case of a gift under the Mahomedan Law it is essential to its validity that the donor should divest himself completely of all ownership and dominion over the subject of the gift and that there should be delivery of possession of the subject of the gift by the donor to the donee while further a gift cannot be made of anything to be performed 'in future' nor can it be made to take effect at any future period whether definite or indefinite. On an examination of clauses 2 to 7 read with clause 10 of the deed of gift of 16th January 1930 (marked F) it will be seen that in respect of the alleged gifts to the sons and wife, and donor has not divested himself completely of all ownership and dominion over the subject of the gift. Neither the sons nor the wife can do with the money so gifted what they like, but on the other hand, it must be invested in the business under the supervision of the donor. Further, even the major sons are not allowed to take and enjoy the earnings resulting from this gift of capital for they will be given only what they may require out of their share and it is apparent that it is the father and not the sons who will decide the measure of the sons' needs. Again in the case of the minor sons, all they will get from the father is maintenance so long as they are minors and when they attain majority, if they should desire to live separately from the father and if it should appear (in his opinion apparently) that such sons

will be able to maintain themselves, they will, like the sons already majors, be given only the amount that they will require. In other words, they have and will have no control either over the corpus of the gifts or their resultant earnings. Further, so long as the father is alive (clause 14 of the deed) they will not be able to withdraw their money from the firm and can only do so after his death.

10. Even greater control is exercised by the husband over the disposal of the alleged gift to his wife. He purports to make her a gift of Rs. 25,000 for her maintenance and her account is credited with that sum in his books, but so long as the donor is alive he defrays her expenses and the income earned by this sum will merely be credited to her account and whatever is thus credited will be given to her after his death. Further even after his death the lady is bound to keep the capital intact and mantain herself only on the income arising therefrom. The lady's hands are obviously completely tied and so long as, at any rate the donor is alive, the so-called gift is only a gift on paper. The gift therefore is no gift under the Mahomedan Law and in my opinion it had not the effect of transferring the money to the so-called donees.

11. It will be seen from paragraph 3 above that of the 9 sons the contribution of the 3 majors and four minors is capital only, while in the case of the 2 other major sons, the share in the firm allotted represents partly capital and partly labour. Even if we treat these two sons as genuine partners, I do not see how, for reasons, stated above, it can be held that the other 2 major sons, the 4 minor sons or the wife are partners, for in my respectful opinion there was not a genuine and legal gift of capital within the terms of the Mahomedan Law. The wife has not acquired dominion and will never acquire dominion over the alleged gift while the sons would acquire dominion if at all, only after the death of their father and a gift 'in future' is not recognised by Mahomedan Law. In my respectful opinion therefore the question as formulated should be answered in the negative. The alleged instrument of partership does not correctly specify the individual shares of the partners and does not give the constitution of the firm correctly, and the registration of the firm on such an instrument was therefore rightly refused.

In view of what has been stated above I do not think we need trouble ourselves with the question whether the legal owner of a wakf property is the Supreme Being and whether the Sup-

reme Being can be a partner in a firm or whether the manager or mutwali of a wakf property can be such a partner nor with the question whether in this case the first manager or settlor complied with the terms of the wakf deed with regard to the investment of the wakf fund and if he did not so comply, whether that is a matter for consideration of the income-tax authorities or whether it is the concern merely of the beneficiaries under the deed of wakf."

Atul Chandra Gupta, *Hemendranarayan Bhattacharjee*, *Apurbhadan Mukherjee* and *Abdul Hussain*, for the assessee.

The Advocate-General, *Dr. Radha Binode Pal*, and *Romesh Chandra Pal*, for the Commissioner.

JUDGMENT.

COSTELLO, J.—This matter arises out of an assessment which was made by the Income-tax authorities in respect of the year 1933-34 on the assessee Hossen Kasam Dada as an unregistered firm on the basis of the total income of Rs. 2,87,846 as against an annual income of Rs. 1,60,854 returned by the assessee. While the assessment proceedings were pending the assessee put in an application said to have been made under Section 2 (14) of the Indian Income-tax Act, 1922, which application is dated the 23rd November 1933 in which the assessee asked for the registration of his firm in accordance with certain particulars which were contained in an instrument of partnership dated the 22nd October, 1933. It appears, however, that the assessee was at the time doubtful as to the validity of that particular partnership deed and, accordingly, a fresh instrument of partnership was entered into which is dated the 25th March 1934, and then on the 10th May, 1934, a fresh application was filed which is also said to have been made under Section 2 (14) of the Act read with Section 26-A of the Act. That application was for registration of the firm in accordance with the terms of the new partnership deed, that is to say, the deed of the 25th March, 1934. The case of the assessee at the time of the application was that the constitution of the firm at all material times was governed by this instrument of the 25th March, 1934. That instrument of partnership purports to constitute a partnership as between twenty different parties and of these parties Nos. 17, 18, 19 and 20 are minors and are represented by Hossen Kasam Dada who is, in fact, their father. According to clause 4 of the instrument of the 25th March, 1934, the partnership was to be deemed to come into exis-

tence, or at any rate, into force, as from the 10th July 1933, on which date new account books for the businesses were to be opened and the partnership was to remain in the first instance for one year terminating on or about the 9th July, 1934, but could be extended by mutual consent of all the parties. The application for registration was dealt with by the Income-tax Officer for Calcutta, District No. IV (1). He gave his decision on the 30th June 1934, whereby he refused the application. From that decision the assessees appealed, as they were entitled to do, under the provisions of Section 30 (1) of the Act of 1922. When the matter came before the Assistant Commissioner of Income-tax, Calcutta, he stated that the matter in issue which he had to decide was the objection of the appellant which lay in respect of the Income-tax Officer's refusal to register the firm. The Assistant Commissioner gave his decision and made his order on the 22nd January, 1935, to the following effect :—

"The orders passed by the Income-tax Officer on the application for registration are hereby confirmed under Section 31 (3) (c)." Thereupon the assessee took steps to have the matter reviewed by the Commissioner of Income-tax in order that the matter might come before this Court upon a reference under Section 66 of the Act of 1922, and an application was made under Cl. 2 of Section 66 on the 16th April, 1935. By that application the assessee requested the Commissioner of Income-tax to put forward certain questions of law for the consideration of this Court. The questions of law formulated by the assessees were these :

(a) Whether the Income-tax Officer has the power to refuse an application for registration made in the prescribed manner with the deed of partnership.

(b) Whether in dealing with an application under Section 26-A for registration of a firm, the Income-tax Officer has the power to enquire into the origin of the money brought by a partner for investment in the firm, or to enter into such questions as to whether a partner has lawful title to the fund invested by him in the partnership, or whether the investment so made by him was unauthorised or in breach of trust.

(c) Whether in dealing with such an application the Income-tax Officer has the power to question the validity of the acts of a manager of the Mohamedan Wakf or of a trustee, in the matter of investment of the Wakf or trust funds.

(d) Whether on a proper construction of the two documents creating the Wakfs in the present case, it can be held that the

action of the present Manager in investing the funds in business partnership was unauthorized.

(e) What is the legal effect of an unauthorized investment by a mutwalli or Manager of a Mohammedan Wakf of Wakf funds in partnership business? Is the investment wholly invalid? And can it be challenged collaterally by any person other than the beneficiaries?

(f) Whether on a proper construction of the instrument of partnership, the partners Nos. 7 and 9 can correctly be regarded as inanimate objects, *viz.*, the Wakf or the funds in question or as non-personal beings like the Almighty, or whether the said partners Nos. 7 and 9 are really represented by their respective managers.

(g) Whether in law there can be partnership in which one or more partners are the Managers of Mohammedan Wakfs?

(h) Whether the delivery of possession in the present case to the several donees evidenced and accompanied by necessary entries in the account books together with the subsequent conduct of the donor and the donees is not sufficient in law to complete and validate the gift?

(i) Is physical delivery of possession absolutely necessary for the validity of a gift under the Mohammedan law even where the donee is either the wife or an infant son of the donor living under his guardianship?

(j) Whether under correct interpretation of the deed of gift of 16th January, 1930 the donees became actual owners of the properties gifted to them? And whether there is anything in the subsequent conduct of the donor and the donees to confirm or modify the ownership of the properties then gifted? Was the direction as to investment in the business not mandatory, and had the major sons and each minor son on his attaining majority the right to take away or remove his money?

(k) Whether assuming but not admitting that the gift was not valid with respect to some of the donees, the Income-tax Officer could legally refuse registration when he found the assessee to be a firm and made the assessment as such?

Upon that application the learned Commissioner of Income-tax decided (as he put it): that

"The real question that arises in this case may be formulated as below :—

Question :—Whether on a correct construction of the alleged deed of gift dated the 16th January, 1930 (and marked F) there

was any valid transfer by gift of money under the Mohammedan Law to the donees named therein?

So that the learned Commissioner of Income-tax seemed to think that the whole matter in dispute between the Income tax authorities and the assessee touching the question of registration depended on whether or not there had been a valid transfer by gift of certain sums of money from Hossen Kasem Dada to his wife and sons. The commissioner in paragraph 6 of the Statement of the case in which he puts the matter for the consideration of this Court sums up the previous proceedings, that is to say, the proceedings before the Income-tax Officer in this way.

"The Income-tax Officer refused to register the firm on the ground that the wakf or mutwali H.K. Dada as manager of the wakf could not in that capacity and in the circumstances of this case be a partner in the firm and on the further ground that the wife of the senior partner and his nine sons were not legally partners on a true-construction of the deed of partnership read with the deed of 16th January, 1930, by which the senior partner purported to make certain gifts to his wife and sons. He held that the mutwalli or the wakf was not a genuine partner for two reasons, firstly, because the wakf was not responsible for any loss which might be incurred by the firm, and secondly, because the mutwalli had not complied with the terms of the wakf deeds directing that the funds of the wakf should be invested in immoveable properties and pending the purchase of immoveable properties in Government securities and should not be invested in business or any commercial activities of a risky nature, while the Assistant Commissioner supported this view on the further argument that under the Mahomedan Law when a wakf has been legally constituted the owner of the property is the Supreme Being and the Supreme Being cannot be a partner in a firm."

The assessees were not content in having the matter put before the Court in such a precise form as that in which the Income-tax Officer thought fit to state it. They were of opinion that there were other matters as set forth in the original questions of law which ought to have received consideration by this Court. Accordingly, they moved for a Rule calling on the Commissioner of Income-tax to show cause why he should not refer to this Court the whole of the questions of law which I have already read and which are set forth at page 24 of the paper book. This matter was heard by the Hon'ble the Chief Justice and the Hon'ble Mr. Justice Panckridge and they directed that a Rule

should issue calling upon the Commissioner of Income-tax to show cause why he should not state the case for the opinion of this Court on the questions Nos. (b) to (j) which are set forth in paragraph 9 of the petition presented to the Court at the trial. The Commissioner of Income-tax has now appeared before us to show cause why he should not state the case for the opinion of this Court and what we have to decide in the first instance, after hearing the argument put forward by Mr. Gupta on behalf of the assessee and the reply made thereto by Dr. Pal on behalf of the Commissioner of Income-tax is whether the Commissioner of Income-tax should still be required to state a case on the particular questions of law as formulated by the assessee That matter is really one which is antecedent to the question of the determination of the one question which the Commissioner of Income-tax did think fit to put forward for the opinion of this Court. I have already read the paragraph in which the learned Commissioner has summarised what took place before the Income-tax Officer and the Assistant Commissioner but I think it desirable that I should refer a little more in detail to what passed in the earlier proceedings.

I deal first of all, with the order made by the Income-tax Officer on the 30th June, 1934. At page 26 of the paper book appears this passage:

"As regards partners Nos. 7 and 9 they are the managers of two wakf funds and appear to have been admitted as partners on account of contribution of capital of the funds. As it was not clear from the partnership deed whether the managers of these two funds could lawfully become partners, the assessees were asked to submit copies of wakf deeds in question. They have accordingly submitted copies of the wakf deeds in Guzarati together with translations in English. They are the deed, dated 28th February 1930 for Hossain Kassem Grant and Dharmay Wakf Fund and the deed, dated 27th January 1929 for wakf- ul-aulad or Kassemi Fund and a supplementary deed, dated the 8th March 1931 to the Kassemi Fund.

The assessees have also filed a note along with their letter, dated 6th June 1934 in which they have made their submissions in connection with the construction of the above documents, for deciding the points at issue.

As I was not satisfied from the above documents as well as the above note, that the partners Nos. 7, 9 and 11 to 20 can be admitted as valid partners, a hearing was given to allow them

further opportunity to make any further submission." Then at page 27 appears this passage:

"It has been submitted by the learned Advocates that the restrictions imposed upon the Trustees do not appear to have been intended to bind the founder himself. I am, however, unable to accept his view. Mere absence of the restrictions cannot mean that the founder did not intend to bind himself with them. Moreover he has clearly forbidden the Trustees to invest the fund in business or to enter into partnership with others or to do any business in the name of the fund. In view of this I think there should be clear direction to the contrary, so far as the founder himself is concerned, in order to empower himself to do what he has forbidden the Trustees to do. In this particular case we find nothing of the sort. The only direction given, so far as the founder himself is concerned, is that he will try to invest in immoveable properties. From this it cannot be inferred that the directions empower him to enter into partnership." It seems quite clear, therefore, from the decision given by the Income tax Officer that he was of opinion that the parties Nos. 7 and 9, as they were the managers of the two wakf firms, could not lawfully be partners in order to constitute partnership and it was mainly on that ground that he refused registration of the firm. When the matter came before the Assistant Commissioner he seems to have based his decision more on the ground which had been touched upon by the Commissioner and not on the ground of delivery of possession of the capital which is said to have been given to the partners who were described as Nos. 11 and 20—they being the sons of the principal partner Hossen Kasem Dada. The Assistant Commissioner puts the matter in this way at page 37 of the paper-book;

"In Mahomedan law (vide paragraph 125A, Mulla's Principles of Mahomedan law), it is essential to the validity of a gift that the donor should divest himself completely of all ownership and dominion over the subject of a gift. Paragraph 125B of the same work says that one of the essentials of a gift is delivery of possession of the subject of the gift by the donor to the donee."

Then on the following page he says:

"Having found that partners 11-20 are not *bona fide* partners, it is really unnecessary for me to consider the question as to whether the two Wakf Funds which are stated to be partners are in effect such, for the application for registration must fail on the finding already arrived at. I will however deal with the point, as the grounds on which I hold that the trusts cannot be partners, are

very much more fundamental, than the reasons for which the Income-tax Officer has refused to admit the funds as partners. Both the funds in question are Wakfs. Under Mahomedan law (vide paragraph 163-B of Mullah's Principles of Mahomedan Law) the moment a Wakf is created all rights of property pass out of the Wakf and vest in the Almighty. The mutwalli is merely a manager or Superintendent, having no vested right in the property of the Wakf. From this it follows that the capital of the Wakf vests in the Almighty. Such being the case, I do not appreciate how a Wakf can be partner in a firm, for section 4 of the Indian Partnership Act defines "Partnership" as the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

"A non-personal Being, such as the Almighty is, is obviously not in a position to enter into relationship with material persons for the sharing of profits of a business and therefore any partnership which purports to exist with a Wakf as a partner can be no partnership in law."

With that statement of law I entirely agree. It has been conceded by Mr. Gupta on behalf the assessees that these two mutwallis of the two Wakfs who are stated to be partners Nos. 7 and 9 cannot really be partners. But says Mr. Gupta that in spite of that they ought to be treated as though they were persons having some kind of share in the profits of the concerns. Therefore although in law they are not, strictly speaking, partners, they were sufficiently in the position of partners as to justify the Income-Tax Officer in granting registration of the firm as applied for by them.

Mr. Gupta has also conceded that the minors, that is to say, the persons who are said to be parties Nos. 17, 18, 19 and 20 cannot, properly speaking, be partners by reason of the provisions of Section 30 of the Indian Partnership Act. But again says Mr. Gupta, although, strictly speaking, these persons could not be partners in this concern nevertheless the provisions of section 30 entail that they should be treated as if they were infant partners and according to what has been laid down in the Income-Tax Manual was no bar to the registration of the firm after excluding these quasi partners and that this was once the practice of the Income-Tax Department. Dr. Pal, on the other hand, says that if this was the practice at one time, it has long ceased to be the practice and the Income-Tax authorities do not allow registration of an instrument of this kind unless all the persons of the

firm are partners in law. I am quite satisfied that it was not possible for the managers of the two Wakfs to be partners in any sense. They are numbers 7 and 9 and they are described thus. "Hossain Kassem Dada, manager or trustee of the Grant and Dharmav Wakf Fund" and "Hossain Kassem Dada the manager or trustee of the Wakf-ul-Aulad or Kassemi Fund." It is to be observed that what purports to be two partners is, in fact, only one person said to have been functioning in two different characters. Moreover he is the same person who is the founder of the firm and the father of the infants who are said to be interested in this firm. It seems to me that as regards the mutwallis of the Wakf there are, as the Income-tax Assistant Commissioner thought' two fundamental difficulties in the way of their being considered as partners. On the one side, there is a provision in the instrument creating the Wakf, which would appear to prevent the investing of the Wakf fund in a commercial business or in any kind of undertaking of a like nature. It seems obvious from the perusal of the deed that what was intended was that the fund should be used in purchasing immoveable properties and not in any other way except that the mutwalli was empowered temporarily to invest the money in Government securities or other securities of like nature. That is looking at the matter from one aspect. From another aspect I agree with the Commissioner of Income-Tax as to the nature of a Wakf fund. We were referred to the judgment of Mr. AMEER ALI given by him in the Privy Council in the case of *Vidya Varuthi Tirtha* v. *Balusami Ayyer*, 48 I.A. 302 at page 312, where His Lordship says: "The Mahommedan Law relating to trusts differs fundamentally from the the English Law. It owes its origin to a Rule laid down by the Prophet of Islam; and means 'the tying up of property in the ownership of God the Almighty and the devotion of the profits for the benefit of human beings'. When once it is declared that a particular property is wakf, or any such expression is used as implies wakf, or the tenor of the document shows, as in the case of *Jewan Das Shahu* v. *Shah Kuburuddin* (2 Moo. I.A. 390) that a dedication to pious or charitable purposes is meant, the right of the wakif is extinguished and the ownership is transferred to the Almighty. The donor may name any meritorious object as the recipient of the benefit. The manager of the Wakf is the Mutwalli, the governor, superintendent or curator." Then at page 315 the learned Judge says "Under the Mahommedan Law the moment the wakf is created all rights of property pass out of the wakif, and vest in God

Almighty. The curator, whether called Mutwalli or Sajjadanishin or by any other name, is merely a manager. He is certainly not a trustee as understood in the English system." That judgment was referred to and approved of by LORD SUMNER in the case of *Abdur Rahim* v. *Narayun Das Arora*, 50 I.A. 84 at page 90, where after quoting the passage from Mr. AMEER ALI's judgment to which I have just referred HIS Lordship said "The principle of the respondents' contention, accordingly, appears to their Lordships to be fallacious. The property in respect of which a wakf is created by the settlor, is not merely charged with such several trusts as he may declare, while remaining his property and in his hands. It is in very deed 'God acre', and this is the basis of the settled rule that such property as is held in wakf is inalienable, except for the purposes of the wakf". In the light of the above statement it seems perfectly clear that it was not possible for the wakf property in the present case to be used for the purposes of a partnership. Therefore, in no sense could it be said that Hossain Kassem as a mutwalli of the two wakfs was a partner with himself and other persons in partnership. I entirely fail to to see how it could be argued that a man can be at one and the same time a partner in his individual capacity and a partner, in a representative capacity. Taking that point alone, it follows, in my opinion, that there was no partnership in law of the description set forth in the application made by the assessees. Sub-section (1) of Section 26-A of the Income-tax Act, 1922, which is now the material section provides that "Application may be made to the Income-tax Officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners, for registration for the purposes of this Act and of any other enactment for the time being in force relating to income-tax or super-tax." Sub-section (2) reads as follows: The application shall be made by such person or persons and at such times and shall contain such particulars and shall be in such form and be verified in such manner, as may be prescribed; and it shall be dealt with by the Income-tax Officer in such manner as may be prescribed." Now the form of the application should be as prescribed in the schedule to rule (3) of the Income-tax rules framed in the Act itself. The way in which the application is to be dealt with is prescribed in rule 4 (1) of the Indian Income-tax Rules which says this: "On the production of the original instrument of partnership or on the acceptance by the Income-tax Officer of a certified copy thereof, the Income-tax Officer shall enter in

writing at the foot of the instrument or copy, as the case may be, the following certificate, namely, 'This instrument of partnership (or this certified copy of an instrument of partnership) has this day been registered with me, the Income-tax Officer, under clause (14) of Section 2 of the Indian Income-tax Act, 1922. This certificate of registration has "effect from the—day of April up to 31st March, 19 ". It seems to me that the Income-tax Officer is only empowered to register a partnership or rather the partnership which is specified in the instrument of partnership which has been put forward or nothing else.

Mr. Gupta says that even if the two wakfs have to be eliminated or even if the infant partners or quasi partners have to be eliminated, nevertheless there remain other partners and they constitute a partnership which can and should be registered. The short answer to that is that if you take away two or more or even one of the persons constituting the constituents of the partnership then what is left is not the partnership which the assessee seeks to register but another partnership altogether, if indeed there is in existence any partnership at all. It is quite clear that it was open to the Income-tax Officer to look into the matter and if any authority is needed for that, one may refer to the case of *In Re Bisseswar Lal Brijlal*, I.L.R. 57 Cal. 1336 at page 1338, where the late Chief Justice of this Court sitting with Mr. Justice BUCKLAND said "It is said that the rules contain no provision for an investigation into the reality of such documents, that is to say, relating to the partnership. Neither they do. On the other hand, under the Act and under the rules the right to present such a document at all is only given to a firm constituted under an instrument of partnership, specifying the individual shares of the partners, and if a firm is not a firm constituted under an instrument of partnership the Income-tax Officer, in my judgment, is not obliged to receive the application at all or to register the document which the parties were putting forward." We have no doubt that both the Income-tax Officer and the Assistant Commissioner were quite right in coming to the conclusion that there was, in the circumstances of this case, no such partnership as that which was put forward by the assessee on the basis of the instrument of partnership deed dated 25th April, 1934. The Income Tax Officer was therefore quite right in refusing registration. Upon that view of the matter, in my opinion, it is unnecessary to trouble the Income-tax Commissioner to put forward a statement of case on the basis of the long catalogue of "questions of

law" formulated by the assessee appearing at page 24 of the paper book.

The Rule is, therefore, discharged with costs—seven gold mohurs.

PANCKRIDGE, J.:—I agree.

Reference No. 1 of 1936.

PANCKRIDGE, J.—The circumstances in which this Reference under sec. 66 (2) of the Indian Income-Tax Act, 1922, has been made have been set out in the judgment delivered by my Lord in dealing with the Rule which has just been disposed of. The substantive question raised by the case stated by the Commissioner of Income-tax is whether on a correct construction of the deed of gift dated the 16th January 1920 there was under Mohammedan Law a valid transfer by gift of money to the donees named therein. One of the reasons for which the Income-Tax Officer considered that he was bound to refuse registration of the firm of Hossen Kasem Dada was that he considered that the gifts to the minor sons of Hossen Kasem Dada by their father were not effective. What was purported to be done was that after the sums had been validly transferred by gift to the minors they were contributed by the minors to the partnership captial. The Income-Tax Officer took the view that as the sums of money were never vested in the minors, they could not be considered to have made any contribution to the capital of the partnership, and under the terms of the partnership deed had, therefore, never become partners, quite apart from any difficulty that might be occasioned by the fact that they had not attained majority. This is one of the reasons for which the Income-Tax Officer refused to register the deed. Inasmuch as we have just decided that the Income-Tax Officer was justified in refusing to register the deed because among the partners shown was Hossen Kasem Dada in his capacity as Manager of the two wakfs, it appears that it would be wasting the time of the Court to ask us to consider whether, apart from this reason, the Income-tax Officer was also justified in refusing to register the deed for the reasons which form the subject-matter of the case stated by the Commissioner of Income tax.

In these circumstances, we do not propose to deal with the Reference, and we decline to answer the question on the ground that no answer is necessary for the guidance of the Income-Tax Department. There will be no order as to costs.

COSTELLO, J.:—I agree. *Order accordingly.*

[IN THE PRIVY COUNCIL.]

TATA HYDRO-ELECTRIC AGENCIES, LTD.

v.

COMMISSIONER OF INCOME TAX, BOMBAY.

LORD RUSSELL OF KILLOWEN, LORD MACMILLAN AND SIR JOHN WALLIS.

March 12, 1937.

BUSINESS EXPENDITURE—MANAGING AGENTS—PAYMENT OF SHARE OF COMMISSION TO THIRD PARTIES—WHETHER BUSINESS EXPENDITURE—ASSIGNMENT OF RIGHTS OF AGENT—PAYMENTS MADE BY ASSIGNEE TO SUCH THIRD PARTIES—WHETHER ADMISSIBLE DEDUCTION—DIFFERENCE BETWEEN PAYMENT OUT OF PROFITS AND PAYMENT OUT OF COMMISSION RECEIVED—WHETHER PROFITS ARE EARNED OR NOT—DIFFERENCE BETWEEN PAYMENTS MADE BY ASSIGNOR AND PAYMENTS MADE BY ASSIGNEE—REFERENCE—BUSINESS EXPENDITURE—WHETHER QUESTION OF LAW OR FACT—INDIAN INCOME TAX ACT (XI OF 1922), S. 10 (2) IX).

If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits are not, it would be difficult to say that the annual payments were made solely for the purpose of the business; and it would make no difference that the annual sum should be made payable out of a particular receipt of the business, irrespective of the earning of any profit from the business as a whole.

Tata Power Co. entered into an agency agreement with Tata Sons Ltd., in 1919 agreeing to pay Tata Sons Ltd., for services to be rendered by them a commission of 10 per cent. on the annual net profits of the Tata Power Co. subject to a minimum of Rs. 50,000 whether that company should make any profits or not. In 1926 D and S advanced funds to Tata Power Co. on the condition that in addition to the interest payable to them by Tata Power Co., on the money advanced, they should each of them receive from Tata Sons Ltd., 12½ per cent. of the commission earned by Tata Sons Ltd. under their agency agreement. In 1929 Tata Sons Ltd., assigned their entire rights under this agency agreement and

other similar agreements with other companies to the assessees, the Tata Hydro-Electric Agencies Ltd. The Tata Power Co. entered into a new agency agreement with the assessees and the asssssees entered into new agreements with D and S in terms identical with the agreements with Tata & Sons Ltd. In the year, *1932 the assessees received a sum of Rs. 5,17,288 and paid one-fourth of it,* viz., *Rs. 1,29,322 to D and S. On a reference by the Commissioner of Income Tax, the High Court of Bombay held, that the case fell within the principle of the Pondicherry Ry. Co.'s case and the sum of Rs. 1,29,322 thus paid by the assessees was not accordingly allowable under Sec. 10* (2) (ix) *of the Indian Income Tax Act as expenditure incurred solely for earning the profits. On appeal by the assesses to the Privy Council:* Held, (i) *that the case was not governed by the* Pondicherry Case *as the obligation to pay D and S a quarter of the commission was quite independent of whether the assessees made any profit or not and the commission was in fact not profit or gain but only an item or factor in the computation of the assessees' profits or gains*; (ii) *but the payments were not made by the assessees in the process of earning profits, nor did they arise out of any transactions in the conduct of their business; the obligation to make these payments was undertaken by the assessees in consideration of their right and opportunity to earn profits, that is, of the right to conduct the business and not for the purpose of producing profits in the conduct of the business, and the payments in question were not therefore expenditure incurred for earning profits within Sec. 10 (2) (ix).*

Held further (*disagreeing with the Bombay Hight Court*)—*That the question whether a payment is an admissible deduction under Sec. 10 (2) (ix) of the Indian Income Tax Act, on the facts as found, is open to argument in the High Court.*

The judgment of the Bombay High Court in Tata Hydro-Electric Agencies Ltd. *v.* Commissioner of Income Tax, Bombay (1936 I.T.R. 92) *affirmed on different grounds.*

Bharat Insurance Co. v. Commissioner of Income Tax, Lahore [1934] (1934 I.T.R. 63; 61 I.A. 41; 147 Ind. Cas. 899; 39 L.W. 250; A.I.R. 1934 P.C. 45; 38 C.W.N. 375; (1934) A.L.J. 236; 36 Bom. L.R. 401; 66 M.L.J. 391; 15 Lah. 224; 59 C.L.J. 175) *referred to.*

C. Macdonald & Co. v. Commissioner of Income Tax Bombay [1935] (37 Bom. L.R. 126; 7 I.T.C. 466; 156 I.C. 274; A.I.R. 1935 Bom. 197; 1935 I.T.R. 459) *commented upon.*

PONDICHERRY RAILWAY CO. LTD. v. COMMISSIONER OF INCOME TAX, MADRAS [1931] (58 I.A. 239; 132 IND. CAS. 619; (1931) A.L.J. 481; A.I.R. 1931 P.C. 165; 35 C.W.N. 895; 33 BOM. L.R. 1263; 51 M. 991; 54 C.L.J. 381) *distinguished.*

ROBERT ADDIE & SON'S COLLIERIES, LTD. v. COMMISSIONERS OF INLAND REVENUE [1924] (8 TAX. CAS. 671) *referred to.*

Appeal from a Judgment of the Bombay High Court.

R. Needham, R. Hills, and *R. Parikh*, for the Appellants.

H. Hull, for the Respondent.

JUDGMENT

LORD MACMILLAN—The appellants are a private limited company who carry on the business of managing agents of the Tata Power Company Ltd. and of certain other hydro-electric companies in India. They acquired this agency business from their predecessors, Tat Sons Ltd. under an assignment dated November 21, 1929, whereby Tata Sons Ltd. transferred to the appellants their whole rights and interest as agents of the hydro-electric companies under their subsisting agreements with these companies but subject, as to their rights and interest under their agreement with the Tata Power Co. Ltd. to their obligations under two agreements with F. E. Dinshaw Ltd. and Richard Tilden Smith respectively. The assignment was declared to be to the intent that the appellants should thenceforth be and act as the agents of the hydro-electric companies and be entitled to all benefits and advantages contained in and conferred by the agreements between Tata Sons Ltd. and these companies and should perform and be bound by all the obligations and duties thereby imposed, and further that the appellants should receive all commissions and other remuneration to which Tata Sons Ltd. were entitled thereunder. The appellants for their part covenanted to carry out and perform the terms and conditions of the agreements with D. E. Dinshaw Ltd. and Richard Tilden Smith and to indemnify Tata Sons Ltd. against any consequences of the non-observance thereof. They further undertook if so required to enter into separate agreements in their own names with F.E. Dinshaw Ltd. and Richard Tilden Smith in the same terms.

Under the agency agreement between Tata Sons Ltd. and the Tata Power Co. Ltd. which was dated September 24, 1919, and the benefit of which the appellants thus acquired, the remuneration of Tata Sons Ltd. for their services consisted of a commission of 10 per cent. on the annual net profits of the Tata Power Co. Ltd.

with a minimum of Rs. 50,000 whether that company should make any profits or not, and they were also entitled to have their expenses reimbursed. In return for this remuneration Tata Sons, Ltd. undertook to use their best endeavours to promote the interests of the Tata Power Company, Ltd. The agreement was declared to be assignable and the Tata Power Co., Ltd. undertook to recognise any assignees as their agents and, if required, to enter into an identical agency agreement with such assignees. It was also declared to be lawful for Tata Sons Ltd., to assign the whole or any part of their earnings under the agreement.

It appears that in 1926 the Tata Power Co. Ltd., were urgently in need of financial fiassistance to the extent of over a crore of rupees. Tata Sons Ltd., their then managing agents, who, as the Commissioner of Income Tax puts it in his statement of facts, "had to find the money" approached F.E. Dinshaw, Ltd., and Richard Tilden Smith who agreed to provide the necessary funds. One of the conditions on which they agreed to do so was that, in addition to the interest payable by the Tata Power Co. Ltd., for the loan, they should each receive from Tata Sons Ltd., two annas in the rupee or 12½ per cent. of the commission earned by Tata Sons Ltd., under their agency agreement with the Tata Power Co. Ltd. Two agreements embodying this obligation were entered into between Tata Sons Ltd. and F.E. Dinshaw Ltd. and Richard Tilden Smith, respectively, dated October 15, and 19, 1926, being the agreements referred to in the assignment by Tata Sons Ltd. of their agency business to the appellants. It will be observed that as the remuneration of Tata Sons Ltd. depended, subject to a minimum, on the prosperity of the Tata Power Co. Ltd. they had an interest in assisting the Tata Power Co., Ltd. to obtain the financial accomodation required for the conduct of their business.

After the acquisition of the agency business by the appellants the Tata Power Co. Ltd. in fulfilment of their obligation under their agreement with Tata Sons Ltd. entered into a new agency agreement with the appellants dated December 17, 1929, in terms identical with those of their previous agreement with Tata Sons Ltd. and the appellants also entered into agreements with F. E. Dinshaw, Ltd. and the administrator of the estate of Richard Tilden Smith (who had meantime died), dated Feb. 23 and May 19, 1932, respectively, in terms identical with those of the previous agreements between Tata Sons Ltd. and these parties.

By this series of transactions complete novation was effected with the result that the appellants came in room and place of

Tata Sons Ltd. in all respects both as regards the right to recieve from the Tata Power Co., Ltd. the stipulated agency remuneration and as regards the obligation to pay out of that remuneration 12½ per cent. to F.E. Dinshaw Ltd. and 12½ per cent to Richard Tilden Smith's administrator.

In the year 1932 the appellants duly earned and received payment from the Tata Power Co. of their commission of 10 per cent. on the net profits of that company and duly paid over to F. E. Dinshaw Ltd. and to Richard Tilden Smith's administrator, 12½ per cent. thereof each, or 25 per cent. in all.

The assessment of the appellant's income for tax purposes for the fiscal year to March 31, 1934, which is in question in the present appeal, is based on their income, profits and gains for the year 1932 and the question is whether in the computation for tax purposes of their income, profits and gains for that year they are entitled to deduct a sum representing the 25 per cent. of the commission earned and received from the Tata Power Co. Ltd. which they paid over to F.E. Dinshaw Ltd. and Richard Tilden Smith's administrator under the agreements abovementioned. The gross commission received by the appellants was Rs. 5,17,288 and the one-fourth thereof which they claimed to deduct Rs. 1,29,322.

Under S. 10 (2) of the Indian Income Tax Act the profits or gains of any business carried on by the assessee are to be computed after making allowance for "(ix) any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains."

The Income Tax Officer refused to allow the appellants to deduct the sum in question in the computation of the profits or gains of their business and the Assistant Commissioner took the same view. The appellant then requested the respondent to refer to the High Court the legal question of the admissibility of the deduction. The respondent in doing so, expressed, as required by the Act, his own opinion which was also to the effect that the deduction was inadmissible. He founded his opinion on the case of the *Pondicherry Railway Company, Ltd.* v. *Commissioner of Income tax, Madras*, which he submitted was on all fours with the present case and he also referred to the case of the *Bharat Insurance Company* v. *Commissioner of Income tax, Lahore*, in which the *Pondicherry* case was followed.

The questions of law as formulated by the Commissioner of Income tax were as follows :—

" (1) Whether in the circumstances of the case and in view

of the provisions of Ss. 4 (1) and 10 of the Act, the assessee company has been correctly assessed on the total amount of Rs. 5,17,288 received by it as profits and gains of the business carried on by it as the managing agents of the Tata Power Co. Ltd.

(2) Whether under the provisions of S. 10 of the Act or under any other provision thereof the assessee company is entitled to have a deduction from the said profits and gains amounting to Rs. 5, 17, 288 to the extent of Rs. 1, 29, 322 paid by it to certain parties under the agreements Exs. F and G (being the agreements between the appellants and F.E. Dinshaw, Ltd., and Richard Tilden Smith's administrator respectively) on the ground that this latter amount was nothing but expenditure incurred solely for the purpose of earning the said profits or gains or on any other ground."

In the High Court the appellants were also unsuccessful. The Chief Justice Sir JOHN BEAUMONT in his judgment held that the whole 10 per cent. commission received by the appellants from the Tata Power Company, Ltd., was properly included without deduction in the assessment of the profits or gains of the appellants' business, in conformity with the decision in the case of *C. Macdonald & Co.* v. *Commissioner of Income Tax, Bombay,* within which, the learned Chief Justice said, that the present case exactly fell. He further expressed the opinion that the question whether the expenditure in question was incurred solely for the purpose of earning the profits or gains of their business was a question of fact and that as there was no finding of fact on which the Court could hold that the deduction claimed was one falling within the statute, the question must be answered in the negative. By their order of March 27, 1935, the High Court accordingly answered the first of the questions stated by the Commissioner in the affirmative and the second in the negative.

In the case of *C. Macdonald & Co.* to which the learned Chief Justice refers, the assessees carried on the business of managing agents of another company from whom they received a commission for their services. This commission the assessees were bound under an agreement to share with certain third parties and they claimed that the shares of their commission which they paid over to these third parties should be excluded or deducted in the computation of the profits or gains of their agency business. The Court held that the case was governed by the decision in the Pondicherry case and that the whole commission received by the assessees must

be included without deduction in the computation of their income for tax purposes.

Before their Lordships, Counsel for the Crown did not seek to support the judgment of the High Court in the present case on the ground that it was ruled by the decision in the *Pondicherry case* and in their Lordships' view he was well advised in recognising the clear distinction between that case and the present case. In the *Pondicherry case* the assessees were under obligation to make over a share of their profits to the French Government. Profits had first to be earned and ascertained before any sharing took place. Here the obligation of the appellants to pay a quarter of the commission which they receive from the Tata Power Co. Ltd., to F.E. Dinshaw Ltd., and Richard Tilden Smith's administrator is quite independent of whether the appellants make any profit or not. Indeed, if on their year's operations as a whole they were to make a loss and incur no liability to income tax, they would nevertheless have to pay away a quarter of the commission in question to the parties named. The commission in truth is not profit or gain: it is only an item or factor in the computation of the appellant's profits or gains. Their Lordships regard this as a fundamental distinction. In the case of *C. Macdonald & Co.*, it would rather appear that the commission which was received by the assessees and which they were bound to share with certain other parties was the sole source of income of the assessees, but, be this as it may, the decision in that case cannot be supported by the authority of the *Pondicherry case* on whatever other ground it may be justified.

It was not questioned by Counsel for the Crown that, if the present question had arisen with Tata Sons Ltd., they would, under S. 10 (2) (ix), have been entitled on the facts stated to deduct their payments to F.E. Dinshaw Ltd. & Richard Tilden Smith as being expenditure incurred solely for the purpose of earning their profits or gains. But he submitted that after the acquisition of the agency business by the present appellants the payments assumed a different character. The appellants, he said, did not take any part in obtaining the loans nor did they incur the liabilities in question in the course of rendering any services to their principals. The obligation to make the payments in question was taken over by them as part of the transaction whereby they acquired the agency business from Tata Sons Ltd., and the payments were, therefore, made not for the purpose of earning profits in the conduct of the agency business but in fulfilment of the terms on which they purchased the business.

Their Lordships recognise and the decided cases show how difficult it is to discriminate between expenditure which is and expenditure which is not, incurred solely for the purpose of earning profits or gains. In the present case their Lordships have reached the conclusion that the payments in question were not expenditure so incurred by the appellants. They were certainly not made in the process of earning their profits; they were not payments to creditors for goods supplied or services rendered to the appellants in their business: they did not arise out of any transactions in the conduct of their business. That they had to make those payments no doubt affected the ultimate yield in money to them from their business but that is not the statutory criterion. They must have taken this liability into account when they agreed to take over the business. In short, the obligation to make these payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business. If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business. It would seem to make no difference that the annual sum should be made payable out of a particular receipt of the business, irrespective of the earning of any profit from the business as a whole. The case of a transferee of a business undertaking liability, for example,for the rents under current leases of the premises in which the business was carried on by the transferor and is to be carried on by the transferee is quite a different case, for the rents paid are clearly an outlay necessary for the earning of a profit. In the case of *Robert Addie & Sons' Collieries Ltd.* v. *Commissioners of Inland Revenue* the Lord President Clyde, dealing with corresponding words in the British Income Tax Act says at p. 235: "What is 'money wholly and exclusively laid out for the purposes of the trade' is a question which must be determined upon the principles of ordinary commericial trading. It is necessary, accordingly, to attend to the true nature of the expenditure, and to ask oneself the question, Is it a part of the Company's working expenses; is it expenditure laid out as part of the process of profit earning?"

Adopting this test their Lordships are of opinion that the deduction claimed by the appellants is inadmissible as not being

expenditure incurred solely for the purpose of earning the profits or gains of the business carried on by the appellants. They thus reach the same result as the learned Judges of the High Court but on different grounds and they would only add in conclusion that will all respect they do not share the view expressed by the learned Chief Justice that the question whether the payments in question were admissible deductions under S. 10 (2) (ix) was not open to argument in the High Court on the facts as found.

Their Lordships will accordingly humbly advise His Majesty that the appeal be dismissed and the order of the High Court of March 27, 1935 be affirmed. The respondent will have his costs of the appeal.

Appeal dismissed.

Messrs. Stanley Johnson and Allen, Solicitors for the Appellants.

The Solicitor, India Office, Solicitors for the Respondent.

[IN THE BOMBAY HIGH COURT.]

SIR CHINNUBHAI MADHAVLAL

v.

COMMISSIONER OF INCOME TAX, BOMBAY.

SIR W. BEAUMONT, C.J., AND RANGNEKAR, J.

March 12, 1936.

MONEY-LENDING BUSINESS—INVESTMENT BY MONEY-LENDER IN DEBENTURE LOANS—LOSS IN INVESTMENT—WHETHER CAPITAL LOSS OR BUSINESS LOSS—RIGHT TO SET OFF—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 24.

Because a man has a business of money-lending, it does not follow that every single transaction which he enters into, which involves the lending of money must be taken as part of the money-lending business. A money-lender, like other people, may invest his capital or accumulated profits in forms of investment which are in law loans, e.g., *Government or Municipal loans, mortgages and debentures and if he invests in such a manner and suffers a loss*

on the investment the loss is a loss of capital and cannot be set off against the profits or gains.

Reference made by the Commissioner of Income Tax, Bombay, under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922), Civil Ref. No. 11 of 1935.

STATEMENT OF CASE.

"Under S. 66 (2) of the Indian Income Tax Act, XI of 1922, (hereinafter referred to as the "Act") and at the instance of Sir Chinnubhai Madhavlal, Baronet of Ahmedabad (hereinafter referred to as the "assessee"), I have the honour to refer, for favour of your Lordships' decision the question of law set out in paragraph 5 below, which has arisen out of the income tax and super tax assessments of the assessee for the financial year 1933-34 ended on 31st March 1934.

2. **Facts of the case.** The facts of the case are briefly these. In April 1920, when the assessee was a minor, his property was under the management of his guardian and mother Lady Sulochana. She desired to start a new Cotten Spinning and Weaving Mill about that time and for that purpose entered into negotiations with one Mr. W.L. Holland of Preston, England, to purchase certain machinery from him. Disputes, however, subsequently arose between her and Mr. Holland as to whether there was any binding contract to purchase the machinery. While these disputes were going on, Mr. Holland came to Bombay and advertised the machinery for sale and about September 1921, a purchaser was found, *viz.*, the Agra Spinning and Weaving Co. Ltd., hereinafter referred to as the Agra Mills. The purchase price fixed was £107,000, but the Agra Mills had no money available for the purpose. Lady Sulochana was at that time the Chief Director of the Ahmedabad Ginning and Manufacturing Co. Ltd., (hereinafter referred to as the Ahmedabad Company) and with a view to settle the above dispute, it appears that an arrangement was arrived at whereby she agreed to provide the major portion of the above purchase price payable to Mr. Holland through the Ahmedabad Company on the security of debentures to be issued by the Agra Mills. £80,000 were to be thus provided for and as regards the balance of £27,000, Mr. Holland agreed, at the same time to accept for himself debentures of that Company (the Agra Mills). On 21st September 1921, the Directors of the Ahmedabad Company accordingly passed a resolution agreeing to take up the above debentures worth £80,000

sterling bearing interest at 8 per cent. and repayable in 8 years in return for a part payment to the extent of £80,000 to Mr. Holland on account of the purchase price of the machinery sold by him. The resolution further empowered the agents to sell off the 3½ per cent. loans worth Rs. 4,47,500 and to use other money belonging to the company for the purpose of investment in the above debentures. A tripartite agreement was thereafter drawn up dated 1st October 1921 (copy annexed hereto marked Ex. A.) to give effect to the above arrangement. Therein the Ahmedabad Company was, as arranged, ostensibly put forward as the lender of the money required by the Agra Mills to purchase the said machinery. This Company had, however, as a matter of fact, no money of its own and the money actually utilised was that belonging to the assessee who was then, as stated above, a minor under the guardianship of Lady Sulochana and who had a very large amount of money deposited with the Ahmedabad Company at interest. When that money was found insufficient for the said purpose, a loan of Rs. 5,00,000 was raised by Lady Sulochana from the Imperial Bank of India Ltd., in April 1923 by depositing War Bonds belonging to the minor's estate. By the above tripartite agreement, the Agra Mills agreed to issue 8 per cent. mortgage debentures, repayable in 8 years, as security for the money raised for the purpose of the above machinery. Accordingly, the machinery was delivered to the purchasers, *i.e.*, the Agra Mills and £80,000 out of the total price of £1,07,000 were paid from the assessee's money from time to time between October 1922 and September 1923. The Agra Mills in return issued from time to time against the amount thus raised, 239 debentures of the face value of Rs. 5,000 each, the total value of all the debentures thus issued being Rs. 11,95,000. Ninety-two of these debentures were alone, however, issued in the name of the Ahmedabad Company. The remaining 147 debentures were issued in the name of Lady Sulochana. Seventy-nine debentures of the face value of Rs. 5,000 each were also issued to Mr. Holland for the balance of the agreed purchase price. Thereafter, in the year 1925, the newly appointed guardians of the assessee (then still a minor) claimed that the 92 debentures standing in the name of the Ahmedabad Company should be transferred to the assessee's name, and by a resolution dated 18th August 1925, the Directors agreed to the said transfer. Meanwhile, however, the Agra Mills had paid no interest on the above debentures at any time after their issue and in 1930, when the debentures became repayable, that company failed to pay.

Ultimately it was taken into liquidation and the assessee then realised only Rs. 3,15,975 on account of the said 239 debentures. The irrecoverable balance due to the assessee was then, after making sundry adjustments, found to be Rs. 8,58,710 and it was written off by him in his accounts for the Hindu *Saṃvat* year 1988.

When the Income Tax Officer, C Division, Ahmedabad, started income tax proceedings for the purpose of assessment for the financial year 1933-34 (ended on 31st March 1934) the above loss of Rs. 8,58,710 written off as aforesaid in the accounts of the assessee for the *Samvat* year 1988 (being the "previous year" for the purpose of the said assessment) was claimed by him as a set off against his income from other sources. The assessee's contention was that the said debenture transaction was nothing but part of his money lending business in which money advanced as a loan had been lost. The Income Tax Officer, however, found on the facts that the loss was a loss of capital and disallowed it. The assessee then appealed under S. 30 of the Act to the Assistant Commissioner of Income Tax, Northern Division, by his petition dated 28th April 1934 (Ex. B). The Assistant Commissioner after hearing the appeal rejected the claim, and confirmed the assessment by his order dated 12th December 1934, a copy of which is annexed hereto marked Ex. C. He also held that the loss was one of capital invested in debentures of the Agra Mills and was not therefore allowable, finding as a fact that though the assessee carried on business as a financier and moneylender the transaction in question had no connection with any such business. He further considered the question whether the transaction was or could be regarded as a dealing in shares and securities and found that it could not be so treated, the assessee in fact not being in the habit of dealing in the purchase and sale of shares or securities. The assessee thereupon by his petition dated 11th February 1935 asked me either to revise the Assistant Commissioner's order and allow the loss or refer the case to this Honourable Court under S. 66 (2) of the Act. A copy of the said petition is annexed hereto marked Ex. D. Accordingly I submit this statement of the case for favour of your Lordships' decision.

4. A copy of the Debenture Trust Deed dated 27th March 1922 executed by the Agra Mills will be produced in Court as, being a bulky document, it has not been printed along with this Reference.

A copy of the form in which the debentures were issued is annexed hereto marked Ex E.

5. Questions for the decision of the High Court: I submit the following question for your Lordships' decision:

"Whether under any provision in the Income Tax Act, XI of 1922, the loss of Rs. 8,58,710 suffered by the assessee on account of money invested in debentures issued by the Agra Spinning and Weaving Co. Ltd., and lost when that company was wound up can, for the purposes of S. 24 (1) of the Act, be treated as 'a loss of profits or gains' under any of the heads of income in S. 6 of the Act and set off against the income of the assessee under any other head, for the purposes of assessment for the financial year 1933-34."

6. **Opinion of the Commissioner**: As S. 66 (2) requires me to give my opinion while submitting this statement of the case, I beg to state that under S. 24 (1) of the Act "where an assessee sustains a loss of profits or gains in any year under any of the heads mentioned in S. 66 he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year. The loss in question has arisen on account of an investment in the debentures of a limited company, the income from which is liable under head (ii) in S. 6, *viz.*, "Interest on Securities". The income under this head "Interest on Securities" is liable to tax as laid down in S. 8 and that section requires that tax shall be payable on the interest received on debentures without any deduction whatever of any kind except commission charged "by a banker realising such interest on behalf of the assessee". In the present case, therefore, the income or loss under this head is to be computed as under:—

	Rs.
Interest received on debentures	Nil.
Commission paid to bankers in realising it	Nil.
Income liable	Nil.

7. Section 6 of the Act lays down that "the heads of income, profits and gains" referred to therein "shall be chargeable to income tax in the manner hereinafter appearing," and as regards the head "Interest on Securities," "the manner hereinafter appearing" is the manner indicated in S. 8 of the Act. As there is a section dealing specifically with this particular head, no other section of the Act can be applied.

8. As there is no provision whatever in the Act to allow any such loss of money invested in securities, be they Government

loans or debentures of a company, the said loss cannot be allowed and I submit the answer to the question should be in the negative.

9. A copy of your Lordships' decision may kindly be certified to me for further action as required by S. 66 (5) of the Act.

Sir J. S. Kanga and *Petigara* with *Messrs. Mulla and Mulla*, for the Assessee.

The Advocate-General with the *Government Solicitor*, for the Commissioner.

JUDGMENT,

BEAUMONT, C.J.—This is a reference made by the Commissioner of Income Tax under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922. I have considerable difficulty in seeing myself what point of law arises having regard to the findings of fact by which, of course, we are bound.

The assessee had lost a substantial sum of money on certain debentures in the Agra Spinning and Weaving Co., Ltd., and he seeks to set that loss off against his profits and gains. The only possible ground on which he can do that is this that he carries on the business, amongst other businesses, of money lending and if he can show that these debentures represent moneys loaned to the Company, as part of his money-lending business, then he would be entitled to duduct the loss from his profits and gains under S. 24: but the finding of fact of the Income Tax Officer is that although the assessee carries on business as a financier and money-lender, the transaction in question had no connection with any such business. Having looked through the record, it seems to me that it would have been quite impossible for the Income Tax Officer to have arrived at any other conclusion. These debentures were taken in the year 1922 under an agreement made in 1921. The assessee being then a minor, the assessee's mother entered into an agreement under which moneys were advanced on debentures to the Agra Spinning and Weaving Co., Ltd., in order to enable them to purchase certain machinery which the assessee's mother had herself originally agreed to purchase. There is nothing whatever to show that the debentures were taken as part of money-lending transactions, and in any case, as I have said, we are bound by the finding of fact that they were not taken as part of money-lending transactions. It cannot seriously be contended that if a man has a business of money-lending, then every single transaction which he enters into, which involves, the lending of money must be taken as part of the money-lending business. It is plain that a money-

lender, like other people, may invest his capital or accumulated profits in forms of investment which are in law loans, *e. g.*, Government or Municipal loans, mortgages and debentures. If he invests his capital in such a manner and suffers a loss on the investment the loss is a loss of capital and cannot be set off against profits or gains.

Having regard to the finding that this transaction was an investment not made in the course of money-lending business, it seems to me that no point of law arises. The actual question raised by the Commissioner is :—" Whether under any provision in the Income Tax Act, XI of 1922, the loss of Rs. 8,58,710 suffered by the assessee on account of money invested in debentures issued by the Agra Spinning and Weaving Co., Ltd., and lost when that Company was wound up can, for the purposes of S. 24 (1) of the Act, be treated as 'a loss of profits or gains' under any of the heads of income in S. 6 of the Act and set off against the income of the assessee under any other head, for the purposes of assessment for the financial year 1933-34."

I am not sure whether I correctly understand the question, but on the findings of fact I am clearly of opinion that the assessee is not entitled to set off the loss in question under any provision of the Income Tax Act.

I think, therefore, the question must be answered in the negative. Costs to be paid by the assessee on the Original Side scale.

RANGNEKAR, J. :—I agree.

Question answered in the negative.

[IN THE CALCUTTA HIGH COURT.]

In the matter of V. G. EVERY.

COSTELLO, J., and PANCKRIDGE, J.

February 17 and 18, 1937.

INCOME TAX—WHERE INCOME 'ACCRUES OR ARISES'—EMPLOYEE OF TEA ESTATE IN INDIA ENTITLED UNDER TERMS OF SERVICE TO RECEIVE SALARY AND COMMISSION ON PROFITS OF ESTATE—COMMISSION RECEIVED WHILE ON LEAVE IN ENGLAND—WHETHER 'ACCRUES OR ARISES' IN INDIA—'ACCRUE',

'ARISE,' 'RECEIVE,' MEANINGS OF—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 3, 4.

The assessee was an employee of the Pathini Tea Co. Ltd., a company incorporated in England. He had agreed to serve the company in the cultivation and manufacture of tea in the estates of the company which were situated in Assam, in British India, for a period of four years, and the company had agreed to pay him a salary of Rs. 800 per month and five per cent. commission on the net profits earned by these estates. During the accounting period 1934-35, he was on leave for seven months. He received salary in India amounting to Rs. 4,000, and while on leave in the United Kingdom he received Rs. 6,965, being the commission earned by him during the year 1933-34, on the basis of the profits made by the company for the year 1932 (1st January to 31st December):

Held, *on a reference by the Commissioner of Income Tax, that in the circumstances, the sum of Rs. 6,965 which was received by the assessee in the United Kingdom, while on leave, must be held to have accrued or arisen in British India within the meaning of Section 4 (1) of the Indian Income Tax Act and was assessable to income tax under that section.*

The words "accruing or arising" in Section 4 (1) of the Indian Income Tax Act mean something different from "received." They indicate some origin or source of growth for the income in question.

COSTELLO, J.—*Questions of this nature should be looked at and decided in the light of commonsense and plain thinking and too much importance should not be attached to or emphasis laid upon the niceties of verbal definitions.*

PANCKRIDGE, J.—*It is not always enough that the income should be earned in British India in the sense that the assessee was in British India for a part of the period or all the period during which the income was earned.*

Commissioner of Income Tax, Bombay v. *Bansilal Motilal (54 Bom.460)* and *Commissioner of Income Tax, Bombay* v. *Sarupchand Hukamchand (55 Bom. 231)* approved; *Commissioner of Income Tax, Burma* v. *Phra Phraison Salarak (6 R. 598)* and *Sir T. Vijayaraghavacharya* v. *Commissioner of Income Tax, Lahore (4 I.T.R. 317)* distinguished.

Cases referred to :

COLQUHOUN *v.* BROOKS [1889] (21 Q.B.D. 52).

COMMISSIONER OF INCOME TAX, BOMBAY *v.* BANSILAL MOTILAL [1930] (I. L. R. 54 Bom. 460; 125 I. C. 691; 4 I. T. C. 332).

COMMISSIONER OF INCOME TAX, BOMBAY *v.* SARUPCHAND HUKUMCHAND [1931] (I. L. R. 55 Bom. 231; A. I. R. 1931 Bom. 236; 5 I. T. C. 108).

COMMISSIONER OF INCOME TAX, BURMA *v* PHRA PHRAISON SALARAK [1929] (I. L. R. 6 Rang. 598; A. I. R. 1929 Rang. 1; 114 I. C. 296; 3 I. T. C. 237).

ROGERS PRATT SHELLAC CO. *v.* SECRETARY OF STATE [1925] (I. L. R. 52 Cal. 1; 83 I. C. 273; 28 C.W.N. 1074; A. I. R. 1925 Cal. 34; 1 I. T. C. 363).

SAUNDERS, *In re* [1931] (I. L. R. 54 All. 223; 1931 A. L. J. 1107; A. I. R. 1932 All. 151; 5 I. T. C. 454).

SIR T. VIJAYARAGHAVACHARYA *v.* COMMISSIONER OF INCOME TAX [1936] (1936 I.T.R. 317).

Case stated by the Commissioner of Income Tax, Bengal, under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922). [Income Tax Reference No. 1 of 1937.]

STATEMENT OF CASE.

"I have the honour to request you to place the following statement of the case drawn up under Sec. 66 (2) of the Indian Income-tax Act, 1922 (Act XI of 1922), before the Hon'ble High Court for decision of the question of law appearing in paragraph 4 below.

2. **Facts of the Case.**—The facts of the case are that Mr. V.G. Every of the Pathini Tea Estate in Assam, received for his services during the accounting period 1934-35 salary in India amounting to Rs. 4,000 plus taxable value of rent-free quarters Rs. 400. During this year Mr. Every was on leave for seven months in the United Kingdom, and while on leave there he received a sum of Rs. 6,965 being the commission earned by him in India during the previous year, *i.e.*, 1933-34. Under terms of his service the assessee is entitled to a percentage of the annual profits earned by the Estate subject to the assessee's being in service of the Estate during that year. The commission was earned during a period in which the assessee was in residence and in service in India.

The Income-tax Officer made an assessment on 20th September 1935 for 1935-36 on income received by the assessee during the previous year, *i.e.*, 1934-35, on a sum of Rs. 7,702 composed of—

		Rs.
Salary	...	4,400
Commission	...	2,902
Other Sources	...	400
	Total	7,702 '

that is, he held 7/12th of the commission as being not liable to tax but only 5/12th as liable, because the assessee was on leave in the United Kingdom for seven months. The assessee wrote a letter, dated 28th September 1935 to the Assistant Commissioner requesting him to enquire into the correctness of the assessment. The Assistant Commissioner (*vide* his letter, dated 15th October) asked the assessee to file his objection in the proper appeal form duly verified and stamped. On 29th October 1935 the assessee filed his appeal in the prescribed form duly verified and stamped. The Assistant Commissioner fixed a date for hearing and passed his order on 16th December 1935; in his order he set aside the assessment and directed a fresh assessment by taking into account the entire amount of commission Rs. 6,965. The revised assessment was made on a total income of Rs. 11, 765 composed of—

		Rs.
Salary	...	4,400
Commission	...	6,965
Other Sources	...	400
	Total	11,765

The assessee appealed against the revised assessment on 8th June 1936 in a petition properly stamped and duly verified to the Assistant Commissioner who confirmed the assessment by his order, dated 7th July 1936. Being dissatisfied with this order, the assessee has asked me to refer the following questions of law which according to him, have arisen out of the Assistant Commissioner's order :—

"(*a*) Can the Assistant Commissioner make any order under Section 31 except on an appeal properly stamped and duly verified and in the prescribed form?

(*b*) Can income received in the United Kingdom by an assessee in the United Kingdom be held to accrue in British India?"

3. The first question does not arise out of the appellate order in spite of which a reference has been claimed, because it is not correct to say that the Assistant Commissioner passed his order,

dated the 7th July 1936 under Section 31 on an appeal petition which was not properly stamped and not duly verified. The application, dated the 11th August 1936, for a reference to the High Court under Section 66 (2) of the Income tax Act is with regard to the above order which the Assistant Commissioner passed on 16th December 1935, and the appeal petition on which he passed that order was properly stamped and duly verified. The order of the Assistant Commissioner on the assessee's petition, dated 28th September 1935, was passed on 15th October 1935, and it was not an order under Section 31 but only an advice to the assessee to file his objection in the proper appeal form which the appellant did on 29th October 1935. I do not, in the circumstances, refer this question to the Hon'ble High Court.

4. As regards the second question, the contention of the assessee is that the amount of commission having been received in the United Kingdom should be exempt from tax. The assessee did not bring this commission or any part of it to British India so as to attract liability under Section 4 (2) of the Act. The question as propounded by the assessee is too abstract and is stated as if it relates to all classes of income. Instead of referring this question in its abstract form, I beg to refer the following question therefrom :

"In the facts and circumstances as stated above, can commission earned by the assessee in British India for services rendered in British India as an employee there, but actually received by him in the United Kingdom, while on leave, be held to have accrued or arisen in British India within the meaning of Section 4 (1) of the Indian Income-tax Act (Act XI of 1922) ?"

5. **Opinion of the Commissioner.**—Mr. Every earned the commission in British India by service during the year 1933-34. In my opinion the whole of this income did thus accrue or arise in British India within the meaning of Section 4 (1) of the Indian Income-tax Act. The amount is wholly earned in British India by a person residing in British India while earning the same and is earned by exertion wholly connected with British India. The simple fact that when this amount was actually paid the person entitled to receive it happened to be in England and thus received the payment thereof there does not in any way affect the time and place of accrual. I would, therefore, respectfully submit that the answer to the question should be in the affirmative as the commission in question did accrue and arise in British India with-

in the meaning of Section 4 (1) of the Indian Income-tax Act 1922.

6. I append to this statement the copies of the following papers :—

1. Assessment order, dated 20th September 1935. 2. Assessee's letter, dated 28th September 1935. 3. Assistant Commissioner's reply, dated 15th October 1935. 4. Assessee's appeal, dated 29th October 1935. 5. Appellate order of the Assistant Commissioner, dated 16th December 1935. 6. Revised Assessment order, dated 6th May 1936. 7. Assessee's appeal, dated 21st May 1936, on the revised assessment, filed on 8th June 1936. 8. Appellate order, dated 7th July 1936. 9. Application of the assessee under Section 66 (2).

Ormond, for the assessee.

Advocate General and *Dr. Radhabinod Pal*, for the Commissioner.

JUDGMENT.

COSTELLO, J.—The point which arises for our consideration in this matter is a short one and is contained in the question submitted to us by the Commissioner of Income Tax, Assam, as appearing in paragraph (4) of his statement of the case. It is this:

"In the facts and circumstances as stated above, can commission earned by the assessee in British India for services rendered in British India as an employee there, but actually received by him in the United Kingdom, while on leave be held to have accrued or arisen in British India within the meaning of Section 4 (1) of the Indian Income tax Act (Act XI of 1922) ?" The facts and the circumstances referred to in the question are briefly these. The assessee Mr. V. G. Every is an employee of the Pathini Tea Co. Ltd., which is a joint stock company incorporated under the English Companies Act having its registered office at No. 14 Fenchurch Street in the City of London. Mr. Every is employed by that company under the terms of an agreement in writing, a certified copy of which has been placed before us. This agreement which is dated 17th February 1933 provides for a term of service for a period of four years calculated from the 1st January 1933. The provisions of the agreement which are relevant for our present purpose are those in clause 7 which runs as follows :—

' In consideration of the due observance and performance by the said employee of the several terms and stipulations which by him ought to be observed and performed and in consideration of

the premises the said Company shall pay the said Employee during the continuance of this agreement a monthly salary to commence from 1st January 1933 and to be paid monthly as follows :—

"Salary ; Rs. 800 per mensem.

Pony allowance Rs. 75 per mensem.

Commission : 5 per cent. on the nett profits of the Pathini and Champabarie Divisions as may be determined by the Secretaries of the Company.

Furlough : Six months of full pay will be granted during the currency or at the expiry of this agreement as may suit the convenience of the Company together with Rs. 1,500 towards the cost of passage.

The said Company shall provide the said Employee with suitable dwelling house accommodation and medical attendance while on the garden free of charge".

The garden referred to is that situated at a place called Pathini and by clause 1 of the agreement the employee is directed to proceed to Pathini or such Tea Garden or Plantation and in such part of India as the said company may direct and "shall serve the said company in the cultivation and manufacture of tea and in such other matters in connection with the business of a Tea Planter and Manufacturer as the said company may from time to time require". The Commissioner of Income Tax sets out in paragraph (2) of his statement of the case that Mr. V.G. Every of the Pathini Tea Estate in Assam received for his service during the accounting period 1934-1935 salary in India amounting to Rs. 4,000 plus the taxable value of rent free quarters which is put at Rs. 400. During this year, that is to say, the tax year 1934-1935, says the Commissioner, Mr. Every was on leave for 7 months in the United Kingdom and while on leave there he received a sum of Rs. 6,965 being the commission earned by him in India during the previous year 1933-34. I pause here to make this observation that it appears that as a matter of fact, the sum which Mr. Every received while he was on leave during the year 1934 must actually have been received in respect of the operations of the company in the year 1932, that is to say, from 1st January 1932 to 31st December of that year. . . . . . because the accounts of the company appear to be made up as at 31st December of each year though they are not actually certified by the Accountants of the company until some such period as the month of May in the succeeding year. The Commissioner of Income Tax proceeded thus: "Under terms of this service the assessee is

entitled to a percentage of the annual profits earned by the Estate subject to the assessee's being in service of the Estate during that year. The commission was earned during a period in which the assessee was in residence and in service in India."

What we are concerned with is the sum of money which was paid to the assessee while he was in England in the year 1934 which he had earned and which was payable to him on the basis of the profits made by the company for the accounting period 1st January to 31st December 1932. This matter has come before us in a rather unusual way because, originally it was never intended by the assessee that any question should come before a Court at all. The local Income Tax Officer made an assessment against Mr. Every on the 20th September 1935, and that was for the year 1935-36 on the basis of income received by the assessee during the previous year 1934-35. The assessment was for a sum of Rs. 7,702 made up as follows :—

Salary Rs. 4,400. Commission Rs. 2,902. Other sources Rs. 400. Total Rs. 7,702.

The Income Tax Officer had taken the view that as regards the commission earned by the assessee seven-twelfths was not liable to tax but only five-twelfths, because the assessee had been on leave in the United Kingdom for a period of seven months. After receiving the assessment Mr. Every wrote a letter dated 28th September 1935 to the Assistant Commissioner and requested him to go into the correctness of the assessment which he had made. We are told that the assessee merely took this course because he did not understand how the figure Rs. 400 as being income "from other sources" had been arrived at. In the answer to this letter the Assistant Commissioner by a letter dated 15th October 1935 requested the assessee to make his petition on a proper appeal form duly certified and properly stamped. Accordingly on 29th October 1939 the assessee did file an appeal in the form prescribed, verified and properly stamped. The Assistant Commissioner of Income Tax fixed a date for the hearing of this appeal and gave a decision on the 16th December 1935. By his order of that date the Assistant Commissioner set aside the assessment made by the Income Tax Officer and directed that a fresh assessment should be made after taking into account the entire amount of the commission, that is to say, Rs. 6,965 instead of merely 5/12ths of that sum. A revised assessment was duly made on a total income of Rs. 11,765 made up as follows :—

Salary	...	Rs. 4,400
Commission	...	Rs. 6,695
Other sources	...	Rs. 400
	Total	Rs. 11,765

The assessee then found himself in a worse position than if he had never raised any question at all on the original assessment and so on the 8th June 1936 he appealed against the revised assessment by means of a petition (properly stamped and duly certified) to the Assistant Commissioner. The Assistant Commissioner by an order dated 7th July 1936 confirmed the assessment, that is to say, the revised assessment. Thereupon, the assessee being dissatisfied with the order which the Assistant Commissioner had made asked the Commissioner of Income Tax, Assam, to refer certain questions of law for the opinion of this Court, questions which according to the assessee had arisen out of the order which the Assistant Commissioner had made. The questions that the assessee desired to refer were these " (a) Can the Assistant Commissioner make any order under Sec. 31 except on an appeal properly stamped and duly verified and in prescribed form? (b) Can income received in the United Kingdom by an assessee in the United Kingdom be held to accrue in British India?".

The views of the Commissioner of Income Tax, Assam, on these questions are set out in paragraph (3) of the statement where he says: "The first question does not arise out of the appellate order in spite of which a reference has been claimed, because it is not correct to say that the Assistant Commissioner passed his order, dated the 7th July 1936 under Sec. 31 on an appeal petition which was not properly stamped and not duly verified. The application dated the 11th August 1936, for a reference to the High Court under Sec. 66 (2) of the Income Tax Act is with regard to the above order which the Assistant Commissioner passed on 16th December 1935 and the appeal petition on which he passed that order was properly stamped and duly verified. The order of the Assistant Commissioner on the assessee's petition, dated 28th September 1935 was passed on 15th October 1935 and it was not an order under Sec. 31 but only an advice to the assessee to file his objection in the proper appeal form which the appellant did on 29th October 1935. I do not, in the circumstances, refer this question to the Hon'ble High Court". Then he proceeds thus: "As regards the second question, the contention of the assessee is that the amount of commission having been received in the United

Kingdom should be exempt from tax. The assessee did not bring this commission or any part of it to British India so as to attract liability under Sec. 4 (2) of the Act. The question as propounded by the assessee is too abstract and is stated as if it relates to all classes of income. Instead of referring this question in its abstract form, I beg to refer the following question therefrom ". He then sets out the question which I stated at the outset of this judgment as being the question we are now required to decide. The opinion of the Commissioner of Income Tax, Assam, himself was that "Mr. Every earned the commission in British India by service there during the year 1933-34". I have already pointed out that the whole of the commission with which we are concerned appears to have been actually earned by Mr. Every in the calendar year 1932. The Commissioner of Income-Tax expressed the opinion that "the whole of this income did thus accrue or arise in British India within the meaning of Section 4 (1) of the Indian Income-tax Act. The amount is wholly earned in British India by a person residing in British India while earning the same and is earned by exertion wholly connected with British India. The simple fact that when this amount was actually paid the person entitled to receive it happened to be in England and thus received the payment thereof there does not in any way affect the time and place of accrual. I would, therefore, respectfully submit that the answer to the question should be in the affirmative as the commission in question did accrue and arise in British India within the meaning of Sec. 4 (1) of the Indian Income-tax Act, 1922."

We have listened with care, and considerable interest to the very full and able argument put forward by Mr. Ormond on behalf of the assessee, but I think there is no doubt that our opinion should coincide with that expressed by the Commissioner of Income-tax, Assam. Mr. Ormond argued, it has also been so argued on many previous occasions in analogous cases, that where the subject-matter of tax is salary or something in the nature of salary, there is very little difference, if any, in meaning as between the words "accrue", "arise" and the expression "received in British India", as used in Section 4 (1) of the Income-tax Act of 1922. The sub-section in its entirety reads as follows: "Save as hereinafter provided, this Act shall apply to all income, profits or gains, as described or comprised in Section 6, from whatever source derived, accruing or arising, or received in British India, or deemed under the provisions of this Act to accrue, or arise, or to be received in British India". Mr. Ormond has asked us to take the view that in

the circumstances of this case commission which was received by Mr. Every in London in the year 1934 was not income, profits or gains which had accrued or arisen in British India. Mr. Ormond based a good deal of this argument upon observations in the judgment in the case of *Rogers Pratt Shellac & Co.* v. *Secretary of State for India in Council* (I. L. R. 52 Cal. 1). There the facts were that the assessee, which was a company incorporated in the United States of America having its Head Office in New York and branches and agencies in various States had a branch office in Calcutta for the purpose of purchasing shellac. The goods as purchased were, I think, sold in the open market in America, on account of another company in America which was to pay the purchasing company a commission of 6 per cent. on the purchase price plus expenses. The assessee company had also a factory in the United Provinces where produce purchased locally was worked up into a form suitable for export. No sales were conducted in India by the company. It was, however, held that the party was liable to pay income-tax and super-tax owing to the provisions of Sec. 3 sub-sec. (1) read with Section 33 sub-sec. (1) of the Indian Income-tax Act of 1918 and Sec. 4 sub-section (1) read with Section 42 sub-Sec. (1) of the Indian Income-tax Act of 1922. The observations I referred to are to be found in the judgment of MR. JUSTICE MUKHERJEE at page 29: where he said "The policy of the Act is to make the amount taxable when it is paid or received either actually or constructively. 'Accrues', 'arises' and 'is received' are three distinct terms. So far as receiving of income is concerned, there can be no difficulty; it conveys a clear and definite meaning, and I can think of no expression which makes its meaning plainer than the word 'receiving' itself. The words 'accrue' and 'arise' also are not defined in the Act. The ordinary dictionary meanings of those words have got to be taken as the meanings attaching to them. 'Accruing' is synonymous, with 'arising' in the sense of springing as a natural growth or result. The three expressions 'accrues', 'arises' and 'is received' having been used in the section, strictly speaking, 'accrues' should not be taken as synonymous with 'arises' but in the distinct sense of growing up by way of addition or increase or as an accession or advantage, while the word 'arises', means comes into existence or notice or presents itself. The former connotes the idea of a growth or accumulation, the latter of the growth or accumulation with a tangible shape so as to be receivable. It is difficult to say that this distinction has been throughout main-

tained in the Act and perhaps the two words seem to denote the same idea or ideas very similar, and the difference only lies in this that one is more appropriate than the other when applied to particular cases. It is clear, however, as pointed by FRY L. J. in *Colquhoun* v. *Brooks* (21 Q.B.D. 52) (this part of the decision not having been affected by the reversal of the decision by the House of Lords), that both the words are used in contradiction to the word 'receive' and indicate a right to receive. They represent a stage anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate". Mr. Ormond, on the strength of the view expressed by MR. JUSTICE MUKHERJEE in that passage, invited us to come to the conclusion, as I have stated, that where it is a question of salary or something in the nature of salary, no distinction or no effective distinction can be drawn between the position which exists when the right to receive arises, and the position which exists when the income is actually received or, to put the matter in another way Mr. Ormond wishes us to take the view that the words "accruing or arising" have nothing to do with the place of origin of the income, *i.e.*, the place at which the income is earned by the proposed assessee. Mr. Ormond suggested that the presence of the words "from whatever source derived" in Sec. 4, sub-sec. (1) indicates that that is the true view of the matter. That, however, is not the opinion of the Bombay High Court as expressed in the case of *The Commissioner of Income-tax, Bombay* v. *Raja Bahadur Bansilal Motilal* (I.L.R. 54 Bom. 460). There are two passages in the judgment of MR. JUSTICE BLACKWELL to which I will first refer. At page 467 the learned Judge said: "In Section 4 (1) of the Indian Income-tax Act of 1922 the words 'accruing or arising' are found in juxtaposition to the words 'or received'. Accordingly I think it plain that the words 'accruing or arising' denote something different from the word 'received', and at page 469 he said:

"I think that the words 'accruing or arising' are used with reference to the place from which the income is derived and the use of the word 'source' in the expression 'from whatever source derived' confirms me in this opinion. In the present case the interest is derived from a loan which was made in British India, that loan, as to the principal, being repayable in British India, and I entertain no doubt that the interest accruing due upon, or arising from, that loan accrues or arises in British India." The facts of the case were that certain promissory notes of the Government

of India bearing $4\frac{1}{2}\%$ interest and repayable in 1955-60 were originally issued by the Government of India to the Imperial Bank of India in British India. The principal and interest were originally payable in British India. These notes were assigned by the Imperial Bank to the assessee and "enfaced" for payment (I dislike the word very much, but it is the word used there) "for payment of interest at Hyderabad (Deccan)." The Commissioner of Income-tax assessed the assessee on the interest on these notes received by him through the Residency Treasury at Hyderabad. The assessee contended that he was not liable to pay either income-tax or super tax thereon as the notes were enfaced for payment outside British India, that is to say, Hyderabad. The learned Chief Justice in his judgment had said: "The use of word 'or' in the phrase 'accruing or arising' means what it says," and that accordingly the two expressions 'accruing or arising' are different from the expression 'received' and further that the expression 'accruing or 'arising' indicate some origin or source of growth for the income in question. His opinion was therefore the same as that of MR. JUSTICE BLACKWELL and with that opinion I respectfully and emphatically agree. There is one other case to which I desire to refer and that is the case of *The Commissioner of Income-tax, Bombay* v. *Sarup Chand Hukumchand* (I.L.R. 55 Bom. 231). In that case the assessees had acted as the secretaries, treasurer and agents of a Mill Company registered at Indore, that is to say, outside British India. Under the terms of their agreement with the Company the assessees were entitled to charge and receive as selling agents of the mill 'commission on the gross sale proceeds of all cloth produced by the mill." The agreement further provided that the assessees were at liberty to retain, reimburse, and pay themselves out of the moneys of the company all sums due to the assessees for commission or otherwise. It appears that the company opened a shop at Bombay for the sale of cloth produced by the company and that the shop at Bombay was managed by the assessees. The sale proceeds, *i.e.*, the proceeds of the sales made in that shop at Bombay were sent to Indore and subsequently, the assessees were paid the commission to which they were entitled in respect of such sales, at Indore. The question arose as to whether the commission earned by the assessees on the sale of cloth at the Bombay shop was liable to be assessed to income-tax in Bombay. The CHIEF JUSTICE and MR. JUSTICE BARLEE took the view that having regard to the terms of the agreement, as the income was commission on sales made in Bombay, that income accrued or arose in British

India and so was liable to be taxed in Bombay, even though as a matter of practice between the parties the commission was actually paid at Indore. The cases I have cited give some indication—considerable indication in my opinion—that it would not be correct to hold that the words "accrue or arise or received" are more or less synonymous and their conjunction in the said section nothing but a pleasure. We must, I think, interpret the section by way of giving a different meaning to the words "accruing or arising" from that ascribable to the word "received." It seems to be however that it makes very little difference for our present purpose whether one takes the view that the word "accrue" is or is not merely an alternative with the word "arise." The important thing to decide is whether those two words, whether taken separately or in conjunction, have a meaning different from the word "received." It is of some significance, for the purposes of deciding the point now before us, to observe the precise language of S. 7 of the Income-tax Act. Sub-section (1) of which says: "The tax shall be payable by an assessee under the head 'salaries' in respect of any salary or wages, any annuity, pension or gratuity, and any fees, commissions, perquisites or profits received by him in lieu of, or in addition to, any salary or wages, which are paid by or on behalf of Government, a local authority, a company, or any other public body or association, or by or on behalf of any private employer." The sub-section, therefore, puts into the category of salaries sums which are payable by way of commission and the monetary value of perquisities or other privileges, such as the right to occupy a rent-free place of residence. Clause 7 of the Agreement which I have already read is, of course, very loosely worded and is by no means clear in meaning, largely owing to the fact that those who entered into the agreement did not take the trouble to omit or alter that part of the printed form which was not strictly applicable to the circumstances of the particular case. It is obviously inaccurate to include as being payable monthly and it would, of course, be impracticable to pay like monthly salary, that part of the employee's remuneration described as "Commission: 5 per cent. on the nett profits of the Pathini and Champabari Divisions as may be determined by the Secretaries of the Company." We must, I think, take it that for practical purposes and for the purposes of this case what was really intended was that although the commission might be payable in a lump sum after the accounts of the company had been made up and an appropriate part of the proceeds assigned to the two divisions named, the commission,

though paid in a lump sum, was nevertheless to be treated as if it were the same thing as salary paid upon a monthly footing. We must, therefore, deal with the question before us by reading Cl. 7 of the Agreement in the light of Sec. 7 of the Act and so upon the footing that salary was being earned by Mr. Every for services rendered by him to the company in their garden or tea plantation at Pathini and that he was only entitled, as the Commissioner of Income-tax, Assam, has suggested, to receive the commission as well as salary properly so called upon the basis that he did, in fact, render these services. Mr. Ormond endeavoured to find some support for his contention that the question should be answered in the negative by reference to the case of *The Commissioner of Income Tax* v. *Phra Phraison Salarak* (I.L.R. 6 Rangoon, 598), where it was held that in the case of an officer employed by the Siamese Government whose salary was payable in Bangkok, for services rendered by him to Government at Moulmein in Burma: "The words 'accrue and arise' (which words may be regarded as synonymous) when applied to income are to be governed by the source from which the income accrues and arises, not by the place where it is received or earned." In my view, however, that case is of no real assistance to the assessee in the circumstances of the present case because it is obvious that the Siamese Forest Officer might have been employed by his Government either in Burma or in Siam or in any other part of the world, and be still entitled to receive the salary he was receiving. As was pointed out in the course of the case, he was not remunerated on the basis of a commission computed on the amount of timber which found its way from Siam into Burma in regard to which it was his duty to keep records and check account. It is that aspect of the matter which, in my view differentiates the present case from the Rangoon Case. Mr. Every was by the terms of his agreement only required to work and could only work and earn his salary in British India and, indeed, within the limits of a specified area or areas in British India and nowhere else. It follows therefore that the right to receive the commission was wholly dependent upon the work done and services rendered by Mr. Every in the tea garden at Pathini. These were a *sine qua non* and a condition precedent to the right to receive not only the remuneration which was termed salary but that part of the remuneration which was described as commission and to be calculated on the basis of 5 per cent. of such part of the net profits of the

company as were referable to the Company's operations at Pathini and Champabari.

It seems to me that when one gets down to the fundamental aspects of the matter we have to decide, it really resolves itself entirely into a question of fact, and one which in my view should be looked at and decided in the light of common sense and plain thinking and not too much importance should be attached to, or emphasis laid upon, the niceties of verbal definitions.

It seems to me, looking at the matter from the point of view of simple common sense and in the freedom from all logomachy it is obviously right and proper to hold that the income which Mr. Every received for his services as an employee in the tea company did accrue or arise in British India, and that in the circumstances of the case it is impossible to ignore the place from which the income came in any consideration of the question whether or not there was an accruing or arising of the income in British India. I would, therefore, answer the question put before this Court in the affirmative.

In the circumstances of this case I think there should be no order as to costs.

PANCKRIDGE, J.—There is very little that I desire to add to the judgment already delivered.

In my opinion the words " accruing and arising " are very wide, and I am in full agreement with those decisions of the Bombay High Court which have laid it down that they mean something different from " being received. "

This view receives support from the language of Sec. 4 (2) which specifically recognises that income, profits and gains may arise or accrue at one place and be received at another.

I think that the question whether any particular income, profits or gains accrue or arise in British India is a question of fact, and it is not practicable to formulate any precise test.

I am inclined to agree that it is not always enough that the income should be earned in British India in the sense that the assessee was in British India for a part of the period or all the period during which the income was earned.

For example, it would not be right in my opinion to hold that a portion of the salary of an officer of the Mercantile Marine accrued or arose in British India, because for some portion of the period during which the salary was earned the officer was serving in Indian waters. In this case it has been pointed out that the

assessee is under a four years' whole time agreement to serve his employers on their Indian tea estates. He cannot be called upon to serve elsewhere nor can he earn salary or commission elsewhere.

The commission payable is paid out of the profits of the Indian tea estates and is a fixed percentage of such profits, and in theory varies with the success and industry of the assessee in relation to the tea estates. This sufficiently distinguishes the case before us from the case of *The Commissioner of Income Tax* v. *Phra Phraison Salarak* (I.L.R. 6 Rang. 598) where the person sought to be assessed could be called upon to serve anywhere.

Moreover in that case the amount of the remuneration bore no relation to the results of the employee's work in British India and was presumably paid out of the general revenues of Siam.

It is not necessary to go so far as the decision in the matter of the *Bishop of Lucknow* (I. L. R. 54 All. 223) for in that case it could not be suggested that the fund out of which the income was paid was connected in any way with British India. The facts of this case are quite different from those in the case of *Diwan Bahadur Sir T. Vijayaraghavacharya* v. *Commissioner of Income-Tax, Punjab, N.W.F.P. and Delhi* (4 I.T.R. 317) where the Court distinguished between pay and pension, although I entertain some doubt whether the distinction in the circumstances was relevant.

I only wish to add in conclusion that the question propounded by the Commissioner is only concerned with accruing or arising within the meaning of S. 4 (1). In so framing the question the Commissioner was carrying out the wishes of the assessee, who suggested the following question:

"Can income received in the United Kingdom by an assessee in the United Kingdom be held to accrue in British India?"

The decision does not therefore touch the question whether, as the Income-Tax Officer thought, a proportionate part of the income was not liable to tax as being leave salary paid in the United Kingdom to an employee of a company while on leave in the United Kingdom within the meaning of exception No. 22 made by the Governor-General in Council under Sec. 60 (1) of the Act.

Reference answered accordingly.

[IN THE CALCUTTA HIGH COURT.]

In the matter of THE OFFICIAL ASSIGNEE FOR BENGAL (Estate of JNANENDRA NATH PRAMANIK).

COSTELLO, J., AND PANCKRIDGE, J.

January 28, 1937.

INCOME TAX—PROPERTY—HOUSE PROPERTY VESTING IN OFFICIAL ASSIGNEE ON INSOLVENCY OF OWNER—OFFICIAL ASSIGNEE, WHETHER LIABLE TO PAY INCOME—' OWNER, ' MEANING OF —INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 9, 41—PRESIDENCY TOWNS INSOLVENCY ACT (III OF 1909), SECTION 17.

Where, on the adjudication of a person as insolvent under the Presidency Towns Insolvency Act, 1909, certain house property of the insolvent vested in the Official Assignee : Held, *that the property did not by reason of the adjudication of the debtor cease to be a subject fit for taxation and in view of the provisions of Section 17 of the Presidency Towns Insolvency Act, the Official Assignee was the ' owner ' of the property and he could rightly be assessed in respect of the income from such property under Sec. 9 of the Indian Income Tax Act.*

Cases referred to :

COMMISSIONERS OF INLAND REVENUE *v.* FLEMING [1929] (14 Tax Cas. 78).

CURRIMBHOY EBRAHIM BARONETCY TRUST *v.* COMMISSIONER OF INCOME TAX, BOMBAY [1934] (1934 I.T.R. 148 ; 7 I.T.C. 195 ; 61 I.A. 209 ; I.L.R. 58 Bom. 317 ; 38 C.W.N. 618 ; 66 M.L.J. 643 ; A.I.R. 1934 P.C. 116 ; 148 I.C. 855 ; 36 Bom. L.R. 557).

Case stated by the Commissioner of Income Tax, Bengal, under Sec. 66 (1) of the Indian Income Tax Act (XI of 1922) ; [Income Tax Reference No. 12 of 1936.]

STATEMENT OF CASE.

I have the honour to draw up a statement of case under Section 66 (1) of the Indian Income Tax Act (hereinafter referred to as the Act) in connection with the assessment proceedings for the year 1934-35 in respect of the above assessee for the income of the year of account ended the 31st March, 1934, involving a

question of law arising out of the said proceedings as set out in paragraph 3 of this letter and to refer the same for the decision of their Lordships.

2. **Facts of the case.**—One Jnanendra Nath Pramanik was adjudged an insolvent by an order of the High Court on the 16th May 1933, and thereupon all his estate and effects vested in the Official Assignee who has since been administering the same. The estate consists of house properties. The Income-tax Officer holding the Official Assignee to be a person covered by Section 41 of the Indian Income Tax Act issued a notice on him under Section 22 (2) of the aforesaid Act on the 24th January 1935, calling upon him to submit a return of the income of this estate. In reply to this notice, the Official Assignee wrote to the Income-tax Officer in his letter No. 118 of the 14th February 1936, intimating that no statement of income in an insolvent estate could be rendered and that all he could do in the matter was to send a statement of the deficiency account as disclosed in the schedule of affairs filed by the insolvent. Copy of the letter is appended and marked A. The Income-tax Officer held that as the legal ownership of the property remained vested in the Official Assignee and as, before the ultimate disposal of the property it fetched income, profits or gains and such income, profits or gains were receivable and received by the Official Assignee, he was the person who was bound in accordance with the provisions of the Income-tax Act to submit a return. As however, no return was submitted, the Income-Tax Officer made an assessment under Section 23 (4) of the Act to the best of his judgment on the 12th March, 1935, the consequent demand notice under Section 29 being issued on the 25th March 1935. In the course of such assessment, the Income-tax Officer found that the income of the estate was from house properties consisting of the following:—

93, Old China Bazar Street.
94, ,, ,, ,, ,,
95, ,, ,, ,, ,,
95-1, ,, ,, ,, ,,
96, ,, ,, ,, ,,
96-1, ,, ,, ,, ,,
97, ,, ,, ,, ,,
97-1, ,, ,, ,, ,,
98, ,, ,, ,, ,,
99, ,, ,, ,, ,,
100, ,, ,, ,, ,,

101 & 101-1, Old China Bazar Street.
102, " " " "
103, " " " "
32, Balaram Mazumdar Street.
121 & 122, Darmahatta Street.
297, Chitpur Road.
14-3-A, Kali Prosad Chakraverty Road.
47-3, Sankar Halder Lane.

The *bona fide* annual value of these properties in terms of section 9 (2) was determined by the Income-tax Officer to be Rs. 9,600 and allowing deduction for statutory repairs under section 9 (1) (i), the net income was determined to be Rs. 8,000 and the tax demanded was Rs. 468-12. On receipt of the demand notice, the Official Assignee in his letter No. 219 of the 28th March, 1935, to the Income Tax Officer contended that no income accrues to an insolvent estate and requested the Income Tax Officer to "put the correspondence before the Commissioner or the Assistant Commissioner so that there may be finality in the matter". With this letter he returned the challan and the demand notice. The Income Tax Officer in reply to this letter informed the Official Assignee that if he was dissatisfied with the assessment made, he could proceed under section 27 of the Income Tax Act or under section 33 of the said Act for review of the case by the Commissioner. He also requested him to pay the tax due and send back the demand notice and the challan to him. In his letter No. 259 of the 10th April 1937, the Official Assignee wrote to the Commissioner of Income-tax sending him copies of this correspondence with the Income-tax Officer and seemed to have suggested settling this dispute by personal interview. Copy of the letter is appended and marked B. To this letter the Commissioner sent a reply in his No. 2310 C.T. of the 22nd May 1935, saying that as the Official Assignee was the legal owner of the properties and that as he came within the purview of section 41 of the Act, the Income-tax Officer was right in making an assessment under section 23 (4) as no return called for under section 22 (2) was filed by him. The Commissioner added that if the Official Assignee would submit a return he would ask the Income-tax Officer to cancel the assessment made under Sec. 23 (4) of the Act and make an assessment on the basis of such accounts as the Official Assignee would produce. Copy of this letter is appended and marked C. The Official Assignee replied to the aforesaid letter of the Commissioner in his

No. 362 of the 5th June, 1935, saying that he did not agree with the view expressed by the Commissioner that he came within the purview of Section 41. Copy of the letter is appended and marked D. Before the Commissioner could dispose of this letter, the Official Assignee in his letter No. 393 of the 19th June, 1936, wrote to the Income tax Officer that by reason of the view taken by the Commissioner of Income-tax, Bengal, in his Letter No. 2310 C.T. of the 22 May, 1935, he dealt with the Income-tax Officer's claim under the provisions of the Presidency Towns Insolvency Act and disallowed the same, holding *inter alia*, that the claim was bad at its inception and not provable in insolvency. He also sent with this letter a copy of the grounds of his decision and added a note at the end to the effect that an appeal lay from his decision to the Judge in Insolvency and the limitation for such appeal was 20 days. Copy of this letter is appended marked E. On receipt of this intimation, the Income-tax Officer informed the Commissioner, whereupon an appeal was filed on the 9th July, 1935, in the Hon'ble High Court. A copy of the petition of appeal is appended and marked F. The matter came on for hearing before the Hon'ble Mr. Justice PANCKRIDGE (Judge in Insolvency) on the 16th July, 1935, when his Lordship by his order of that date was pleased to direct as follows:—

"It is ordered that the said decision of the said Official Assignee be and the same is hereby set aside and this Court does not think fit to make any order as to the costs of the parties herein".

A copy of this order is appended and marked G. On receipt of the order of the Hon'ble Court, the Official Assignee was asked to make the payment of the demand due. To this request the acting Official Assignee in his letter of the 4th September 1935, requested that the time fixed for payment might be extended till the end of December 1935. He also intimated that on the re-opening of the High Court after the long vacation he intended to apply to the Court for direction, *inter alia*, as to whether the Official Assignee was under any obligation (*a*) to make the returns asked for and (*b*) to pay the income-tax demanded. In reply to this letter the Official Assignee was informed that in view of the decision of the Hon'ble High Court setting aside the Official Assignee's orders the demand already made by the Income-tax Officer remained effective. He was therefore again requested to make the payment of the demand without delay and it was added that if the Official Assignee filed a return, even if under protest, in a subsequent case and an assessment was made, it would be permissible for

the Official Assignee to press the matter in appeal and if not satisfied with the result of the appeal to take the matter to the Commissioner for a reference under Section 66 (2) of the Act, if necessary. The acting Official Assignee on receipt of this letter interviewed the Commissioner and in his letter No. 708 of the 13th November, 1935, requested the Commissioner to permit this case (as well as two other cases) to remain in abeyance until the permanent Official Assignee returned. He also added that he would retain in his hands sufficient money to meet the claim of this department in respect of the estates under discussion. The Commissioner agreed to this whereupon the acting Official Assignee wrote back as follows :—

"I hereby undertake without prejudice, to retain in my hands sums sufficient to meet,

(a) the amount of income-tax claimed in the Estate of Jnanendra Nath Pramanik and Moosaji Hasan Asmal,

(b) the costs incurred by your department in the application made to the High Court with reference to your claim in the Estate of Jnanendra Nath Pramanik.

Please on receipt kindly let me know the actual amount of such costs.

In retaining in my hands the amount of such costs, I make no admission that you are entitled to be paid any part thereof."

When the permanent Official Assignee resumed duties he with his letter No. 137 of the 24th February, 1936, sent a cheque for a sum of Rs. 468-12-0 under protest and requested the Commissioner to state a case to the High Court in accordance with the provisions of the Indian Income Tax Act with regard to the purview of Section 41 of the said Act so that the question as to whether the Official Assignee was liable to submit a return and pay tax in respect of properties of persons who were adjudged insolvents under the Presidency Towns Insolvency Act, subsequent to insolvency could be determined. A copy of this letter is appended and marked H.

3. Arising out of the facts and circumstances stated above I have the honour respectfully to formulate the following question and refer the same for the decision of their Lordships :—

"Whether, when on the making of an order of adjudication under the Presidency Towns Insolvency Act (Act III of 1909) the property of the insolvent becomes vested in the Official Assignee and such Official Assignee takes possession thereof, the

tax in respect of the income, profits and gains of such property chargeable under the Income Tax Act (Act XI of 1922) and received by the Official Assignee should or should not be leviable and recoverable from such Official Assignee."

4. **Opinion of the Commissioner.**—The only source of income in question in this case is house property. This house property vested in the Official Assignee under the Presidency Towns Insolvency Act. Section 9 of the Indian Income Tax Act provides :—

"The tax shall be payable by an assessee under the head 'Property' in respect of the *bona fide* annual value of property consisting of any buildings or lands appurtenent thereto of which he is the owner.............."

In my opinion when property vests in the Official Assignee under the Presidency Towns Insolvency Act, he becomes its owner within the meaning of this Section 9 and consequently so far as the house property is concerned, tax shall be payable by him in respect of its *bona fide* annual value. This is what has been done and I do not see how the Official Assignee can avoid this taxation. Then again there is Section 41 of the Income Tax Act which runs thus : —

"In the case of Income, profits or gains chargeable under this Act which are received by the Courts of Wards, the Administrators-General, the Official Trustees or by any receiver or manager (including any person whatever his designation who in fact manages property on behalf of another) appointed by or under any order of a Court, the tax shall be levied upon and recoverable from such Court of Wards, Administrator-General, Official Trustee, receiver or manager in the like manner and to the same amounts as it would be leviable upon and recoverable from any person on whose behalf such income, profits or gains are received, and all the provisions of this Act shall apply accordingly."

The Official Assignee is an officer who has been appointed by the order of the Hon'ble High Court and is a person who in fact manages property on behalf of another. In my respectful opinion therefore, the Official Assignee is one of the persons contemplated by Section 41 and as he is the owner of the house property for the time being by reason of the same being vested in him and is in receipt of its income he is amenable to all due processes available under the Act, like any other assessee, and as such, bound to submit a return when called upon to do so under Section 22 (2) of the Act in respect of the income from the said house property. He was duly served with the requisite notice under

Section 22 (2) of the Act and was given ample time for complying with that notice. But he made default in complying with this notice and the Income Tax Officer made the assessment to the best of his judgment in respect of what he found to be the *bona fide* annual value of the property. If there were any sufficient cause for his default, the Official Assignee might have taken steps under Section 27 of the Act. This he did not do. In fact there was no sufficient cause preventing him from making the return. It is not the case of the Official Assignee that he was prevented from making the return by any such cause. He did not make the return wilfully and he still asserts that it was not his duty to make such a return. So the only question involved in this case is whether the Official Assignee is the proper person in whose hands the income under the head 'property' is chargeable to tax under the Income Tax Act. In my opinion both under Section 9 and Section 41 he is the person liable to be assessed and consequently he has been rightly assessed.

5. In addition to the papers which have been mentioned as being appended, I enclose relevant extracts from the assessment order relating to this case. (Appendix I.)

W. W. K. Page and *B.C. Mitter*, for the Assessee.

Advocate-General of Bengal, *Dr. Radhabinod Pal*, and *R.C. Pal*, for the Commissioner.

JUDGMENT.

COSTELLO, J.—This matter comes before us on a Reference under Sec. 66 (1) of the Indian Income-tax Act, 1922, in respect of an assessment for the year 1934-35 for the income of the year of account ending 31st March, 1934.

The question propounded by the Commissioner of Income Tax, for our consideration is stated in paragraph 3 of his statement of the case and is in this form "whether, when on the making of an order of adjudication under the Presidency Towns Insolvency Act (Act III of 1909) the property of the insolvent becomes vested in the Official Assignee and such Official Assignee takes possession thereof, the tax in respect of the income, profits and gains of such property chargeable under the Income-tax Act (Act XI of 1922) and received by the Official Assignee should or should not be leviable and recoverable from such Official Assignee".

The facts briefly stated were these:

One Jnanendra Nath Pramanik was adjudged an insolvent by an order of this High Court on the 16th May 1933. Thereupon all

his estate and effects vested in the Official Assignee by virtue of the provisions of Sec. 17 of the Presidency Towns Insolvency Act. The Official Assignee since the date of the adjudication has been administering the estate of the insolvent. That estate consists of certain house properties situated in the city of Calcutta. The Income Tax Officer took the view that the Official Assignee was a person falling within the purview of Sec. 41 of the Indian Income Tax Act and, accordingly, he issued upon him a notice under Sec. 22 (2) of the Act. That notice was dated 24th January 1935 and required the Official Assignee to submit a return of the income of the insolvent's estate. In reply to that notice, the Official Assignee wrote a letter to the Income-tax Officer dated 14th February 1935 in which he intimated that no statement of income in an insolvent estate could be rendered and that all that he could do in the matter was to send a statement of the deficiency account as disclosed in the schedule of affairs which was filed by the insolvent. The Income-tax Officer was apparently of the opinion that as the legal ownership of the property remained vested in the Official Assignee and as before the ultimate disposal of the property it produced income, profits or gains and as such income profits or gains were receivable and received by the Official Assignee he was a person who was bound in accordance with the provisions of the Income Tax Act to submit a return. No return was, however, submitted and accordingly, the Income-tax Officer exercised the powers conferred on him by Sec. 23 (4) of the Act and made an assessment to the best of his judgment. That assessment was dated 12th March, 1935. Consequent upon that a demand notice under Sec. 29 of the Act was duly issued on the 25th March 1935. In connection with the assessment which had been made, the Income-tax Officer found that the income of the estate was derived from certain house properties most of which were situated in Old China Bazar Street and the rest in other streets of this city. The entire estate in fact consists of these properties. The *bona fide* annual value of the properties was the criterion to be applied for the purpose of assessment of the income-tax. That is by virtue of the terms of Sec. 9, sub-section (2), of the Act. That value was determined by the Income Tax Officer to be Rs. 9,600 and allowing deduction for repairs as permitted by Sec. 9 (1) the net income was determined to be Rs. 8,000 and the tax demanded was Rs. 468 12 as. On receipt of the demand notice, which I have already mentioned, the Official Assignee in a letter to the Income-tax Officer dated 28th March 1935 contended that no income accrued to

the insolvent estate and requested the Income-tax Officer to put the correspondence before the Commissioner or Assistant Commissioner to arrive at a finality in the matter and with this letter he returned the demand notice. The Income-tax Officer in reply informed the Official Assignee that if he was dissatisfied with the assessment made, he could proceed under Sec. 27 of the Income Tax Act or under Sec. 33 of the Act for a review of the case by the Commissioner of Income-tax. I need not enter into further details as to the subsequent proceedings which ultimately led up to the Commissioner of Income-tax deciding to state the case for an opinion of this Court. The amount of the tax, *i.e.*, the sum of Rs. 468-12 aforesaid was paid under protest on the 24th February 1936.

The question which we have to decide is the one which is set out in paragraph 2 of the case. The Commissioner of Income Tax points out that the only source of the income in question in this case was the house property. That house property vested in the Official Assignee under the Presidency Towns Insolvency Act 1909. Now Sec. 9 (1) of the Indian Income-Tax Act provides that "tax shall be payable by an assessee under the head 'property' in respect of the *bona fide* annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portion of such property as he may occupy for the purposes of his business, subject to the following allowances" mentioned thereunder. The Commissioner of Income-tax expressed the opinion that when property vests in the Official Assignee under the provisions of the Presidency Towns Insolvency Act he becomes the owner of the property within the meaning of section 9 of the Income Tax Act and consequently, in the case of house property, tax becomes payable by the Official Assignee in respect of the *bona fide* annual value of the property which has vested in him. The Commissioner of Income Tax has stated "This is what has been done and I do not see how the Official Assignee can avoid this taxation." He then makes reference to section 41 of the Income Tax Act (a section which we have had to consider quite recently) which runs thus "In the case of income, profits, or gains chargeable under this Act which are received by the Courts of Wards, the Administrators-General, the Official Trustees or by any Receiver or Manager (including any person whatever his designation who in fact manages property on behalf of another) appointed by or under any order of a Court, the tax shall be levied upon and recoverable from such Court of

Wards, Administrator-General, Official Trustee, Receiver or Manager in the like manner and to the same amounts as it would be leviable upon and recoverable from any person on whose behalf such income, profits or gains are received, and all the provisions of this Act shall apply accordingly." Now the Commissioner says, in his opinion, the Official Assignee is an Officer who has been appointed by an order of the High Court and is a person, who in fact is managing property on behalf of another. The Commissioner expresses his opinion in these words "the Official Assignee is one of the persons contemplated by section 41 and, as he is the owner of the house property for the time being by reason of the same being vested in him and is in receipt of its income he is amenable to all due processes available under the Act, like any other assessee, and as such, bound to submit a return when called upon to do so under section 22 (2) of the Act in respect of the income from the said house property. He was duly served with the requisite notice under section 22 (2) of the Act and was given ample time for complying with that notice. But he made default in complying with this notice and the Income Tax Officer made the assessment to the best of his judgment in respect of what he found to be the *bona fide* annual value of the property." Finally, he says "In my opinion, both under section 9 and section 41 he is the person liable to be assessed and consequently he has been rightly assessed."

Now it is our task to decide whether that is so and whether on the facts and in the circumstances of this case the Official Assignee was liable to be assessed and whether he was rightly assessed. It is to be observed that the Commissioner of Income-tax bases his opinion both upon the provisions of section 9 and upon the provisions of section 41.

Mr. Page appearing on behalf of the assessee argues that neither of those sections applies to the circumstances of this case. I am of the opinion that Mr. Page is correct to this extent that those sections cannot *both* apply to the circumstances of this case and the most that can be said is that one of them may apply. Mr. Page's first point was that the subject matter of the assessment with which we are concerned changed its character when it passed into the hands of the Official Assignee and that although it was house property when it belonged to the insolvent and as such would have been a fit subject matter of income tax upon the basis of the *bona fide* annual value, yet when it passed into the hands of the Official Assignee (by reason of the provisions of section 17 of

the Presidency Towns Insolvency Act) the property ceased to have the same taxable quality and was no longer a fit subject for taxation in the hands of the Official Assignee. With that contention I find myself unable to agree. In my view, *vis-a-vis* the revenue there was no change of character whatever. The house property consisted of a number of houses in this city. Normally, they would be the subject of income tax upon the basis of their *bona fide* annual value. It cannot make any difference whether they are in law the properties of Jnanendra Nath Pramanik or whether in law they have become vested in the Official Assignee of the insolvent estate. The real question we have to decide is whether we should look at the matter from an angle of the person concerned or rather whether on looking at the person concerned it can rightly be said that the Official Assignee was the owner of the property so as to bring him within the four corners of the provisions of section 9. If he was the owner that is sufficient to make him liable to assessment. If he was not the owner then we have to consider whether he is one of the class of persons enumerated in section 41 of the Income Tax Act.

With regard to the first point, Mr. Page argued that although by section 17 of the Presidency Towns Insolvency Act these properties vested in the Official Assignee he did not thereby or thereupon become the owner of those properties within the meaning properly ascribable to that word for the purposes of the applicability of section 9. What Mr. Page really invited us to do was to restrict the meaning of the word by putting before it the qualifying adjective "beneficial." What was argued by Mr. Page was that the Official Assignee had no legal interest in the properties themselves, they were merely vested on him for the purposes of the administration of them in the interest of the creditors of the insolvent. I am unable to accept Mr. Page's contention. In this country there is no difference between "legal estate" and "equitable estate." In this connection the case of *Sir Currimbhoy Ebrahim Baronetcy Trust* v. *Commissioner of Income Tax, Bombay*, (61 I. A. 209) is of assistance. At page 217 SIR SYDNEY ROWLATT when giving the judgment of the Privy Council made this observation: "In their Lordships' opinion the effect of the Act creating these trusts is not to give the baronet for the time being any right to any part of the interest or property specifically or any right which, even granting that the legal title is not the only thing that can ever be looked at, would make it true to say that any proportion of the interest is not 'receivable'

or any proportion of the property is not 'owned' by the incorporated trustees ".

The point we have to decide is I think covered by the opinion in a case to which our attention was drawn by Mr. Advocate General namely, the case of the *Commissioners of Inland Revenue* v. *Fleming*, 14 Tax Cases 78. The headnote of that case is "The Respondent's estates were sequestrated in 1921 under the Bankruptcy (Scotland) Act, 1913, and a trustee was appointed. The assets included heritable properties subject to mortgages, and the rents were applied by the trustees in payment of mortgage interest and redemption of mortgages, but not in payment of dividends to creditors. At the close of the sequestration the Respondent was re-invested in those properties which had not been sold, and received the balance of rents in the trustee's hands. Ordinary creditors received 9s. in the £, out of the amount realised by the trustees, and the Respondent obtained his discharge in 1926 on payment of a composition of a further 1s. in the £.

The Respondent thereupon claimed repayment of tax suffered on the heritable properties for each year from 1920-21 to 1925-26 in respect of the personal allowance to which he contended he was entitled. It was contended that in spite of the sequestration the radical right in the estate remained with the bankrupt and that the income arising during sequestration was his income for Income Tax purposes. On appeal, the General Commissioners admitted the Respondent's claim ".

It was there held that during sequestration the income from the sequestrated estate which was vested in the trustee, was the trustee's income and not the bankrupt's, and that neither the trustee nor the bankrupt was entitled to claim the relief sought. There is a significant passage in the judgment of His Lordship in that case in which His Lordship stated thus: It is obvious that, unless during the years in question the annual value of the properties was income of the Respondent, he cannot have any claim to abatement of it for Income Tax purposes; and accordingly everything depends upon the soundness of the proposition that the income consisting in the annual value of these properties was truly income of the Respondent. I do not see how it can possibly be so described. It was part of the income arising from the sequestrated estates vested in the trustee for the Respondent's creditors. Any income that did arise from these estates was income of the trustee as such, and he (and he alone) had the right to put it into his pocket as income. It was not income that

went or could go into the pocket of the Respondent as income in any of the years in question. How then can it be said to have reached his pocket as income of his subsequent reinvestiture? What was he reinvested in? It is said that he was reinvested in whatever substance remained of the radical right belonging to him all along. But the radical right of a bankrupt in his sequestrated estate is nothing but a right of reversion to the balance remaining after the creditors are satisfied, for which balance he is entitled to call the trustee to account. It is not, I think, a specific right to any particular assets, or a right which applies specifically to that part of the reversion which originated from revenue on the one hand and that part which originated from capital on the other hand". It seems to me that this opinion of the Lord President is ample authority for taking the view that the property had become entirely vested in the Official Assignee and that the income derived from the said property became the income of the Official Assignee for the purpose of income tax and so subject to taxation. In the present case the income was in the nature of statutory income arrived at upon the basis of the *bona fide* annual value of the property in question. On the authority of the case I have just cited and indeed, on general principles arising out of the provisions of section 17 of the Presidency Towns Insolvency Act we have come to the conclusion that it is right to say that the Official Assignee is the owner of the property which was the subject matter of the particular assessment with which we are now concerned. Upon that view of the matter, it is not necessary to consider, I think, whether or not the provisions of section 41 of the Income-tax Act of 1922 can be prayed in aid by the Income-tax authority for the purpose of extracting tax from the Official Assignee in the circumstances such as the present. Nor do we think it necessary to consider whether there were any other assets which might have come into the hands of the Official Assignee in connection with this particular insolvency. All we are concerned with is the property which is the subject-matter of the particular assessment.

We are not prepared to give answers to hypothetical questions or to deal with circumstances which are not directly in point in connection with questions formulated by the Commissioner of Income Tax and submitted to us for our opinion. I hold that the Commissioner of Income Tax was right in his view that the Official Assignee was a person liable to assessment and that the Official Assignee was rightly assessed under the provisions of Section 9 of the Indian Income Tax Act, 1922.

We make no order as to costs in this reference.

PANCKRIDGE, J.—I agree.

Reference answered accordingly.

[IN THE CALCUTTA HIGH COURT.]

In the matter of KESHARDEO CHAMRIA.

COSTELLO and PANCKRIDGE, JJ.

March 4, 1937.

PROPERTY—SUIT FOR DECLARATION OF TITLE AND PARTITION—CONSENT DECREE DECLARING PLAINTIFF AND DEFENDANT ENTITLED TO EQUAL SHARES AND APPOINTING COMMISSIONER FOR PARTITION—ORDER DIRECTING THEM TO COLLECT RENTS JOINTLY—MODE OF ASSESSMENT—ASSESSMENT OF EACH INDIVIDUALLY IN RESPECT OF HIS HALF SHARE—LEGALITY—'OWNER', 'ASSOCIATION OF INDIVIDUALS', MEANINGS OF—MEMBERS OF HINDU UNDIVIDED FAMILY AFTER PRELIMINARY DECREE FOR PARTITION, WHETHER AN ASSOCIATION—APPOINTMENT AS MANAGER, WHAT CONSTITUTES—INCOME TAX ACT (XI OF 1922), SECS. 9, 41—SEC. 41, WHETHER MANDATORY OR DISCRETIONARY.

Before a person can be taxed as an 'owner' under Sec. 9 of the Indian Income Tax Act, it must be decided that he is in fact the owner of the property in question and this decision rests with the Income Tax Officer subject to the rights of appeal under Secs. 30 and 31. But the mere existence of a dispute as to title, even where a suit has been filed, cannot of itself hold up an assessment until the final determination of the suit.

The words 'other association of individuals' in Sec. 3 of the Indian Income Tax Act must be construed according to the ejusdem generis *rule with reference to the word 'firm' preceding it and they do not cover the members of an undivided Hindu Mitakshara family after a preliminary decree for partition has been made. The members of such a family are in the same position as members of a Dayabhaga family and can be individually assessed in respect of their shares.*

To bring a person within Sec. 41 of the Indian Income Tax Act, it is not enough that he should be appointed to 'manage' the property, but he should further manage it 'on behalf of another'.

In a suit for declaration of title and partition, a consent decree was passed declaring that the plaintiff (the assessee) and the defendant were equally entitled to the residue of the estate of a deceased person and a commissioner for partition was appointed. The parties were jointly given liberty to realise the rents of the joint estate on joint receipt and to meet the necessary expenses thereout. The income-tax authorities treated the assessee and the defendant as 'owners' of the properties in equal shares and levied income-tax on the assessee on half the annual value.

Held, *that the assessee and the defendant were not managers of the properties in question appointed by or under any order of a Court within the meaning of Sec. 41 of the Indian Income Tax Act and the Income Tax Officer did not act illegally in assessing the assessee in respect of his share of the property.*

Quære, *whether the application of Sec. 41 of the Act is mandatory when the conditions specified in the section are fulfilled.*

Cases referred to:

COMMISSIONER OF INCOME TAX, MADRAS *v.* J. V. SALDANHA (1932) (55 Mad. 891; 62 M.L.J. 600; A.I.R. 1932 Mad. 378).

TRUSTEES OF SIR CURRIMBHOY EBRAHIM BARONETCY TRUST *v.* COMMISSIONER OF INCOME TAX, BOMBAY (1934) (L.R. 61 I.A 209; 58 Bom. 317; 38 C. W. N. 618; A.I.R. 1934. P.C. 116; 148 I.C. 855; 36 Bom. L. R. 557; 2 I.T.R. 148; 7 I.T.C. 155).

Case stated by the Commissioner of Income Tax, Bengal, under Sec. 66 (2) of the Indian Income Tax Act.

STATEMENT OF CASE.

At the requst of the assessee, Babu Keshardeo Chamria, a case is stated for the decision of Their Lordships, the Honourable Judges of the Calcutta High Court, on the question of law which I formulate in paragraph 6 below.

2. The matter at issue arises out of two assessments made one for the year 1933-34 on the income of the financial year 1932-33 and the other out of the assessment made for the year 1934-35 on the income of the financial year 1933-34. In the former year, the assessee returned under section 22 (2) of the Act an income of Rs. 186 but was assessed on a total income of Rs. 48,628 made up as follows:—

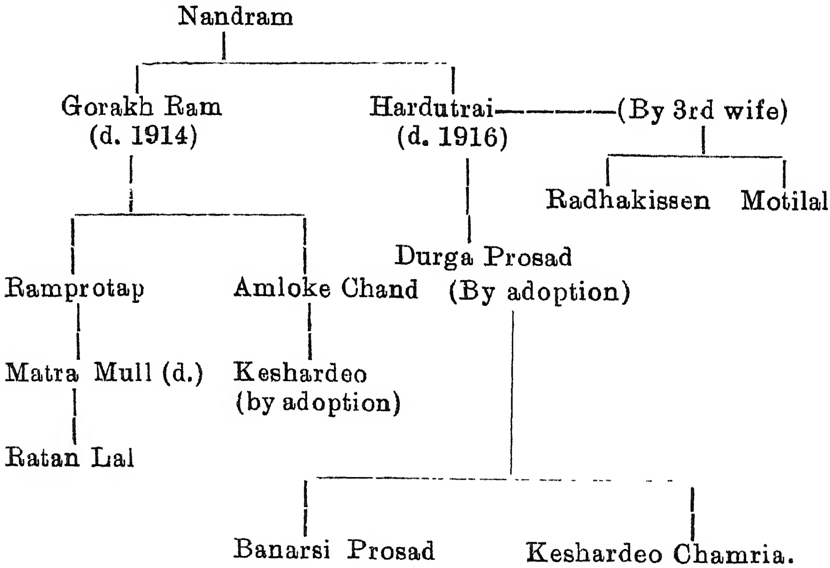
		Rs.
Interest on securities	...	814
Property	...	33,920
Partnership profit	...	12,192
Other sources	...	1,702

For 1934-35 he returned an income of Rs. 185 and was assessed on a total income of Rs. 54,558 as below :—

		Rs.
Interest on securities	...	496
Property	...	28,177
Share in a partnership business	...	25,850
Other sources	...	35

In both these cases income under the head 'Property' was computed under section 9 of the Indian Income Tax Act and represented the assessee's share of the *bona fide* annual value of certain house properties of which the assessee is the owner of 8 annas share, and the question that is being referred affects the assessment only is respect of this income under the head 'Property.'

3. The assessee comes of a Hindu family, the geneological table of which I set out below :



Litigation has been going on in the courts for many years between the various members of this family and the facts of this litigation, so far as they are material to this case, are as follows. There was at one time a very prosperous business carried on in the name of Hardutrai Chamria and before his death in 1916 the shares of the different members of the family in that business were determined as follows :—

		Rs.	A.	P.
Ramprotap Chamria	...	0	3	6
Amloke Chand Chamria. (Now represented by Keshardeo Chamria)	...	0	3	6

Durga Prosad Chamria	...	0	3	0
Radha Kissen Chamria	...	0	3	0
Motilal Chamria	...	0	3	0

Ramprotap Chamria had amassed considerable savings and purchased a large number of properties in Calcutta and, Howrah. In 1929 the present assessee as plaintiff instituted against Rai Bahadur Ramprotap Chamria and his minor grandson by a predeceased son Ratan Lal Chamria Suit No. 183 of 1929 in the High Court of Calcutta in its ordinary original Civil Jurisdiction alleging that the assessee was the adopted son of Amloke Chand, that Ramprotop and the assessee were members of a Hindu family joint in estate and that the said Ramprotop Chamria had all along been managing the joint family properties and had been misappropriating the rents and profits thereof. The assessee therefore instituted the suit for declaration that he was the son of Amloke Chand and was entitled to half share in the joint properties named by him in Schedule A attached to his plaint as also for enquiry as to what other properties were joint and for possession, for partition and for accounts. By a consent decree of the Court dated 23rd May 1930 it was declared that the assessee was entitled to one equal half part or share of the residue of this joint estate after setting apart the sum of Rs. 11 lakhs for allottment to Ramprotop and it was further ordered that a partition be made of the said properties into two equal parts or shares and that Commissioners be duly appointed for this purpose and that after partition had been effected a mutual conveyance to each other of the respective shares should be executed. A copy of the said consent decree is appended and marked A. It is understood that final effect has not yet been given to that order and that the property has not yet been partitioned and that litigation is still goingon between the two parties regarding the question as to what more joint assets the Rai Bahadur had at his disposal. The shares of the respective parties are not disputed and the ownership of the actual items of property which has till now been disclosed by the Rai Bahadur and which alone are the subject matter in this assessment is not questioned. The assessee is not satisfied with the assets which have been shown by Ramprotop and he in his different petitions has alleged that the said Ramprotop has other joint properties at his disposal. In that suit by a further order of the court dated 28th July the Official Receiver was appointed Receiver *pendente lite* of the moveable properties and of the rents, issues and profits of the immoveable properties belonging to the parties of the suits men-

tioned in the plaint with power to him to get in and collect the outstanding debts and claims due in respect of the said property and with all the powers provided for in Order 40, rule 1, clause (4), of the Civil Procedure Code with certain exceptions with which we are not now concerned. The property in question in the present assessment was covered by this order.

The Receiver, so appointed did not succeed in taking possession of property and on the 2nd April 1931 the plaintiff in that suit (*viz.*, the present assessee) made an application alleging in its paragraph that since the order appointing the receiver it was agreed between the parties:—

(*a*) that the Official Receiver shall not take possession of the following immoveable properties and shall, without prejudice to the right of either party to apply for re-instatement of the Receiver, be discharged from acting as Receiver in respect of such properties:—(after this the list of the properties was given but it would be sufficient to say that this list completely covers the properties relevant for our present purposes).

(*b*) that the plaintiff (present assessee) and the defendant Ramprotap are jointly given liberty to realize the rents of the above properties on joint receipts, duly to make the necessary expenses thereout and to file rent suits.

(*c*) that the documents of title be kept in joint custody of the plaintiff Keshardeo and the defendant Ramprotap,

(*d*) that Ramprotap and Keshardeo are also given liberty to invest the money which will come to their hands or divide the same equally,

(*e*) that liberty be given to either party to apply for an order for re-appointment of Receiver of the rents, issues and profits of the abovenamed properties without any objection on the part of the other party in the event of their not being able to agree as to collections, disbursements, investments or distribution of the said rents, issues and profits and on such application being made by either party the other party shall consent to such appointment.

On this applicption the following order was made by the Court on the same date:—

"It is ordered that the said order dated the 28th day of July last do stand varied in the manner indicated in the Schedule hereunder written and it is further ordered without prejudice to the rights of either party to apply to the Court for the re-appointment of the said Official Receiver as the Receiver of the properties

mentioned in the said Schedule (hereinafter referred to as the said properties) in the circumstances and on the conditions also mentioned in the said Schedule and the said Official Receiver be and he is hereby discharged from further acting as the receiver of the said properties. And it is further ordered that the costs of and incidental to this application be costs in the partition proceedings."

This was the complete order and the Schedule referred to in the order was only a copy of the contents of paragraph 5 of the petition already reproduced above.

That arrangement remained in force till 23rd August 1933 when on the application of the parties another order was passed re-appointing the Official Receiver as Receiver pendente lite of this property again, but the Official Receiver reports that he did not get actual possession till the 23rd or 24th February 1934 and presumably, therefore, the joint managers, that is, Ramprotap and Keshardeo, the assessee, remained in possession up till the later date, collected the income of the property and it will be pertinent to notice that they distributed the collected amounts between themselves in equal shares.

4. The Income-tax Officer in making his assessment for the two years in question proceeded to tax the assessee directly in respect of his share of income derivable from this property taxable under Section 9 of the Act and did not make an assessment in the first instance on the joint managers, that is, the asseesee and Ramprotap and for the purpose of arriving at the quantum of income assessable in respect of this property he examined the rent account of the Official Receiver in whose hands these accounts then were, took the amount of rent received or receivable as representing the *bona fide* annual value and after making the usual deductions required by section 9 of the Act arrived at a net figure of income which he distributed half and half between the assessee and his co-sharer Ramprotap. It is admitted that the income from property has been divided half and half between the parties to the litigation or at any rate that when one party drew a cheque for a certain amount the other party drew a cheque for a similar sum. The total amount drawn by each of them during the years 1932-33 and 1933-34 was Rs. 41,580 and Rs. 12,786 respectively. Babu Ramprotap Chamria has not challenged the correctness of the procedure as followed by the Income Tax Officer in this case and has willingly paid the amount of tax demanded.

5. Arising out of these assessments, the assessee has formulated 9 questions of law which are common to both the assessments

and 2 further questions which arise or can arise only out of the assessment for the year 1934-35. The questions as formulated are appended to this statement of case and marked B.

6. Excepting those formulated as questions (d), (h) and (i) the others either do not arise in the facts of this case or should not be allowed to be raised as not having been raised at any earlier stages. The only contention of the assessee having any semblance of substance is that which he seeks to raise by his questions (d), (h) and (i). His contention is that as the property in question was under joint management of himself and Rai Bahadur Ramprotap Chamria by or under an order of the High Court in Suit No. 183 of 1929, the tax in respect of its income can be levied only upon such managers by virtue of the provisions of section 41 of the Income Tax Act. In my respectful opinion this is the only matter that arises for the decision of Their Lordships in this case and this can in my opinion, be covered by the question which I formulate below :—

" Whether in the circumstances described above the present assessee and Rai Bahadur Ramprotap Chamria were the managers of the properties appointed by or under any order of a Court within the meaning of section 41 of the Indian Income Tax Act and whether in the facts and circumstances given above the Income Tax Officer acted illegally in assessing the present assessee in respect of his charge of the property ? "

7. I respectfully submit this question for Their Lordships' decision.

8. It is to be noted that the managers and the owners are in this case the same persons or at any rate were so at the time the income was received and that in the ultimate event which happened each owner received his share of the income at all relevant times.

9. The assessee's argument is based on section 41 of the Act which says that in the case of income, profits or gains chargeable under the Act which are received by the Court of Wards.........
..............................or by any receiver or manager appointed by or under any order of Court, the tax shall be levied upon and recoverable from such Court of Wards..........................
receiver or manager in the like manner and to the same amount as it would be leviable upon and recoverable from any person on whose behalf such income, profits or gains are received. In my opinion, the assessee and his co-sharer Rai Bahadur Ramprotap Chamria cannot be said to be the persons appointed by or under

the order of a Court to manage the property on behalf of another within the meaning of Section 41 of the Indian Income Tax Act. I have already set out the circumstances under which they managed these properties. The consent decree declared them to be the owners of these properties in equal shares. The decree determined their respective shares in these properties and directed partition. After this decree it was certainly open to them to possess their respective shares amicably. A Receiver was no doubt appointed pending actual partition ; but the owners came to an amicable arrangement settling the mode of interim enjoyment and as a result of this arrangement the receiver was discharged. In their application for discharge of the Receiver they made no prayer for their own appointment as Receiver and as a matter of fact the Court made no such appointment. Till the actual partition they were entitled to possess jointly and by mutual agreement they did so possess. They only bar to their thus possessing and enjoying the property was the order appointing a receiver and they got this bar removed by having that order of appointment discharged. The only sought co-owners' "liberty" to manage and enjoy jointly, this liberty having previously been taken away by the Court's order making appointment of the Receiver.

Further they themselves were the owners of the properties and their management thereof was not on behalf of anybody else. In any case in view of the agreement to divide the income equally and of the actual distribution of the same, the management was for themselves and not for anybody else. In my opinion, therefore, Sec. 41 of the Act has no application to this case and the Assessee and Rai Bahadur Ramprotab Chamria were not joint managers appointed by or under the orders of a Court within the meaning of that section.

Even assuming that they are such managers within the meaning of the section, the question will be whether it was incumbent upon the Income-tax Officer to make assessment in the joint names of these managers. It must be noticed that whatever assessment would be made under Section 41 it would be in like manner and to the same amounts as it would be leviable upon and recoverable from any person on whose behalf such income, profits or gains are received. The managers received the profits in question (*viz* , half of the income from these properties) on behalf of the present assessee and even if assessment were made in the joint names of the managers, the quantum of income assessed in respect, of these properties would have been the same. In my opinion,

even after such assessment the amount would have been realisable from this assessee as one of the joint assessees and it would have made no practical difference specially in view of the fact that the other co owner has already been assessed for his half share and has already paid that tax.

I would further like to point out that the section seems to apply only to those cases where income, profits or gains chargeable under the Indian Income Tax Act are received by the persons named in the section. I would contend that where the income chargeable is merely a notional income it can hardly be said to be received by anybody. In the case of house properties tax shall be payable in respect of the *bona fide* annual value of the property and it will be payable by the owner of such property. It does not seem to matter who manages and receives the rents and profits of the property. This seems to follow from Sec. 9 of the Act and in this view Sec. 41 would not at all apply to house properties.

Further, it may be pointed out that Sec. 41 is on the same line as Sec. 40. In interpreting this Sec. 40 it has repeatedly been pointed out that this is not a charging section at all. It is only a machinery or enabling section providing that under the circumstances mentioned in this section, tax can be levied upon and recoverable from persons other than the person to whom the income actually belongs. I may here refer to the decision of the Madras High Court in *J. V. Saldanha* v. *Commissioner of Income Tax* (I.L.R. 55 Mad. 891; 6 I.T.C. 114) where some decisions of the English and the Indian Courts have been referred to and relied upon. What has been said of Sec. 40 in this respect will equally apply to Sec. 41 and in my opinion these sections do not relieve the real owners from liability to be taxed directly. Sec. 3 is the charging section and it makes the tax in respect of any income leviable upon the person whose income it is. Neither Sec. 40 nor Sec. 41 excludes or limits the operation of this section. These sections only extend its operation making the tax leviable also upon persons other than those whose income the chargeable income is. The word "shall" in the expression "the tax shall be levied" in these sections simply indicates the imperative nature of the obligation of these Guardians, Agents, Trustees, Receivers, etc. It does not compel the Crown to resort to these provisions.

In consideration of all this, my respectful opinion is that assessment in this case has been legally made direct on the owners and that the question formulated should be answered accordingly by their Lordships.

10. I attach to this statement of case copies of the following papers in addition to a copy of the questions formulated under Sec. 66 (2) for the two years and a copy of the consent decree referred to in paragraph 3 :—

(1) Assessment order for 1933-34 and 1934-35 with their appendices showing method of computation of income under S. 9.

(2) Grounds of appeal against both these assessments.

(3) Appellate orders (common in both assessments).

(4) Applications filed under Sec. 66 (2) in connection with the assessment for both years.

S. N. Banerji and *A. C. Sen*, for the Assessee.

The Advocate-General of Bengal, Dr. R. B. Pal and *R. C. Pal* for the Commissioner.

JUDGMENT

PANCKRIDGE, J.—This reference under Section 66 (2) of the Indian Income Tax Act arises out of circumstances of some complexity.

The assessee Keshardeo Chamria instituted a suit in 1929 on the Original Side of the Court, for a declaration that he had been validly adopted by one Amloke Chand deceased and was accordingly entitled under Mitakshara Law to certain immoveable properties jointly with the defendant Ramprotap, Amlok Chand's brother. There was also a prayer for partition.

Ramprotap filed a written statement denying the adoption, and also denying that the properties alleged by the assessee to be joint family properties were in fact such with the exception of one No. 23 Cullen Place, Howrah.

On May 23, 1930, a decree was made by consent. Unfortunately the decree has been drawn up in somewhat ambiguous language, and still more unfortunatley the Commissioner of Income tax appears to be under a misapprehension as to its effect.

It was agreed under the terms of settlement annexed to the decree that the assessee was the validly adopted son of Amloke Chand. The decree further declared that the assessee was entitled to one equal half part or share of the residue of the joint estate mentioned in the terms, after setting apart eleven lacs of rupees for allotment to Ramprotap, and also after setting apart certain of the premises in suit for religious and charitable purposes.

Ramprotap was then declared entitled to the remaining equal half part or share. Commissioners of partition were appointed and directions given for accounts and for mutual conveyances on the basis of the award to be made. Now from the language of the

decree one would expect to find a list of admitted joint properties in the terms of settlement and on the other hand, if no properties were admitted to be joint, one would expect in the body of the decree directions on the Commissioners to enquire what the joint estate consisted of.

In fact there is no list of joint properties nor any direction for such an enquiry. Indeed it is admitted that the consent decree did not settle the dispute in so far as the alleged joint nature of the properties claimed in the plaint was concerned, and we have been told that the present commissioner of partition is in fact holding an enquiry of the sort indicated. Unfortunately the Commissioner of Income tax states more than once in his Letter of Reference that the consent decree declared the assessee and Ramprotap to be owners of the properties in suit in equal shares.

On July 28, 1930 the Official Receiver was appointed Receiver of the properties (described in the order as "the immoveable properties belonging to the parties to this suit").

An important order was made by consent on April 2, 1931. The Official Receiver was discharged in respect of the properties, and the assessee and Ramprotap were jointly given liberty to realize the rents thereof on joint receipt and to meet the necessary expenses thereout, and to file rent suits. The documents of title were to be kept in the joint custody of the assessee and Ramprotap. Ramprotap and the assessee were given liberty to invest the money which would come into their hands or divide the same equally. There was also liberty to either party to apply for the re-appointment of the Official Receiver, who in point of fact was re-appointed under an order of the Court dated August 23, 1933. The Commissioner of Income-tax states that the Official Receiver did not obtain possession until the latter part of February 1934.

The Income tax Officer has in these circumstances disregarded the order of August 1933 and has treated the financial years 1932-33 and 1933-34 on the basis that the order of April 2, 1931 was effective throughout.

No objection has been taken to this way of treating the assessment, the assessee's complaint being that on the basis of the 1931 order the Department should have applied Sec. 41 of the Indian Income-tax Act.

During the years in question the assessee and Ramprotap in exercise of the liberty given them under the order have been collecting the rents of the properties and dividing them equally.

The Income-tax Officer in these circumstances has treated the rents collected subject to the statutory deduction as the *bona fide* annual value of the properties within the meaning of S. 9 of the Income-tax Act, and the assessee and Ramprotap as the "owners" of the properties in equal shares. He has accordingly included half the annual value in the assessable income of the assessee under the head "property" the actual amounts being Rs. 33,920 out of a total income of Rs. 48,628 for 1932-33 and Rs. 28,177 out of a total income of Rs. 54,558 for 1933-34.

The assessee appealed against the orders of the Income-tax Officer made in the two assessments, but the Assistant Commissioner dismissed the appeals and confirmed the orders of the Income-tax Officer.

The matter was then taken to the Commissioner of Income-tax, before whom the assessee formulated certain questions of law (see appendices B and B (1) to the Statement of the cases).

The Commissioner has taken the same view as the Assistant Commissioner and the Income-tax Officer, but has referred the following question of law to this Court :—

"Whether in the circumstances described above the present assessee and Rai Bahadur Ramprotap Chamria were the managers of the properties appointed by or under any order of a Court within the meaning of Section 41 of the Indian Income-tax Act, and whether in the facts and circumstances given above the Income-tax Officer acted illegally in assessing the present assessee in respect of his share of the property ?"

If I understand the assessee aright he maintains first that for purposes of assessment he is not the owner of the property within the meaning of S. 9.

Alternatively it is said that if the assessee is in any sense the owner, he is only so as a member of an "association of individuals" within the meaning of S. 3.

Next it is argued that whether he is the owner or not the provisions of S. 41 apply and are mandatory. In other words, at the time that the income was received, it was received by the assessee and Ramprotap as Managers appointed by or under an order of the Court, and half can only be assessed in that capacity.

It will be noticed that most of these submissions are not directly connected with the question formulated by the Income Tax Commissioner, but at the same time it is, I think, necessary for us to express our views upon them.

It may not at first sight be apparent in what respect the assessee has been prejudiced by the suggested failure of the Department to apply S. 41, because if the tax had been deducted while the rents were in the hands of the assessee and Ramprotap as joint managers, although the money available for division would have been less, the dividend presumably would not be liable for tax.

The assessee however suggests that, if all or any of the disputed properties are found not to be joint, he will be called upon to refund to Ramprotap what he has drawn in respect of that property without any allowance for the income-tax paid.

I do not think it necessary to speculate as to the position which will arise in such a case, for I cannot see that such considerations can affect the construction of the Section.

Now with regard to the ownership of the property, the position is that the assessee has been assessed in respect of property of which at the time of assessment he alleged he was the owner, and of which he still alleges himself the owner, for he does not object to the assessment on the ground that he is not the owner.

He points out however that his title is disputed, and that to establish it he has been compelled to institute a suit which may terminate in part at any rate in favour of Ramprotap, who until the Official Receiver was appointed on July 28, 1930, was in possession of the disputed properties.

To adopt the language of the assessee's counsel the law says owners shall be taxed, it does not say that claimants shall be taxed.

Now it is clear that before an assessee can be taxed as an "owner" under S. 9 it must be decided that he is in fact the owner of the property in question, and in my opinion this decision rests with the Income-tax Officer, subject to the rights of appeal under Secs. 30 and 31. The mere existence of a dispute as to title, even where a suit has been filed, cannot of itself hold up an assessment otherwise it would be open to an assessee to delay assessment indefinitely by arranging for the institution of collusive proceedings.

This difficulty is not met by pointing to S. 41, because as often as not in a suit for declaration of title and ejectment no Receiver is appointed, and the possession of the party remains undisturbed.

It appears therefore that the Income-tax Officer has *prima facie* the power to decide that the assessee was the owner of a

half share in the properties without waiting for the final determination of the High Court suit.

It is hard to see in this case how the decision, if it is to be called a decision, of the Income-tax Officer could have been other than it was. The assessee has throughout asserted ownership and has never appealed against the assessment on the ground that he is not the owner. It is true that the Commissioner appears to be in error in considering that the assessee's ownership has been declared by the partition decree, but having regard to the assessee's assertion of ownership and the arrangement embodied in the order of April 2, 1931, it is impossible to say that the decision of the Income-tax Officer was wrong.

With regard to the contention that the owners are an association of individuals within the meaning of S. 3, it is enough to say that this point is not raised in the letter of reference. In my opinion however, the words "other association of individuals" must be construed according to the *ejusdem generis* rule with reference to the word "firm" preceding it, and they do not cover the members of a formerly undivided Mitakshara family after a preliminary decree for partition has been made. The members of such a family appear to me to be in the same position as the members of a Dayabhaga family, and it has never been suggested as far as I know that members of such a family cannot be individually assessed in respect of their shares.

As regards the provisions of S. 41, the section with which this reference is directly concerned, the assessee's contentions are first that the income, profits and gains represented by the annual value of the immoveable properties have been received by him and Ramprotap as "Managers" within the meaning of the Section and secondly, that the provisions of the section are mandatory, and that where its conditions are fulfilled the Department can only look to the manager, and has no recourse to the person upon whose behalf the income, profits and gains are received. On the other hand, the Crown maintains that the section cannot apply in the circumstances of this case, and further submits that even if the section is applicable, it merely provides machinery for collection, which is available to the Department, and which the Department is not compelled to employ.

For the latter contention the Crown relies on the observations of the Madras High Court in the *Commissioner of Income Tax, Madras* v. *Saldanha* (I.L.R. 55 Mad. 891). There a widow was assessed under S. 10 (1) of the Income Tax Act in respect of

a business carried on by her and belonging partly to her and partly to her children. It was contended that the tax should be separately assessed on the various owners of the business and levied on the widow as guardian under S. 40. Dealing with S. 40 the Court states at page 898 :—

"Now the argument based on Sec. 40 may first be disposed of. Sec. 40 and the following sections have been held to be not charging sections but only machinery sections. Sec. 40 provides that the trustees or guardians shall be assessed in a like manner and to the same extent as the beneficiaries or wards may be assessed. Apart from the fact that these are not charging sections it may also be observed that they are enabling sections, *i.e.*, the Income-tax Officer can take steps to assess the trustees or guardians as representing their separate beneficiaries or wards as the case may be, if he so chooses. But the sections do not compel the Crown to resort to them. The question in the case before us is not whether the Income-tax Officer can proceed under Sec. 40 or not but, where he has not chosen to proceed under Sec. 40 but proceeded to assess on another basis, Section 40 can be relied upon as preventing him from doing so. It is clear that the section cannot be so utilised."

The assessee questions the soundness of the observations made by the Madras High Court, on the authority of *Trustees of the Sir Currimbhoy Ebrahim Baronetcy Trust* v. *The Commissioner of Income-tax, Bombay* (L.R. 61 I.A. 209) where the Judicial Committee held that in the circumstances of the case the interest on securities was "receivable" by the Trustees within the meaning of S. 8 and that the property was "owned" by them within the meaning of S. 9.

Neither case appears to me to be a direct authority on the question whether the application of the sections (including S. 41) grouped under Chapter V of the Act is mandatory or discretionary.

Even on the assumption that the sections are mandatory when the conditions specified in them are fulfilled, the assessee and Ramprotap are not in my opinion within the purview of S. 41.

The order of April 2, 1931, does not specifically appoint them to be Receivers or Managers, although having regard to the previous order and to the duties and powers conferred I should hold that they could properly be described as "Managers".

But to bring them within S. 41 it is not enough that they should be appointed to "Manage" the property, they must manage it "on behalf of another".

The assessee maintains that he and Ramprotap are managing the property on behalf of that one of them who will ultimately be found, as a result of the suit, to be entitled to the property.

In my judgment the Income-tax Officer, having found, as he was entitled to do, that the assessee and Ramprotap are owners of the property in equal shares, was at liberty, if not bound, to treat them as managing, not on behalf of an unascertained owner, but on behalf of themselves.

It follows that they have been rightly assessed and taxed directly. The answer to the question referred by the Commissioner will accordingly be that the assessee and Ramprotap were not managers of the properties appointed by or under any order of a Court within the meaning of S. 41 of the Indian Income Tax Act, and that the Income-tax Officer did not act illegally in assessing the assessee in respect of his share of the property. The assessee must pay the costs of the reference.

The rule stands discharged with costs—10 gold mohurs.

COSTELLO, J.—I agree.

[IN THE HIGH COURT OF BOMBAY.]

MESSRS. RAMKUMAR KEDARNATH

v.

THE COMMISSIONER OF INCOME TAX, BOMBAY.

SIR WILLIAM BEAUMONT, C. J., AND RANGNEKAR, J.

12th March, 1936.

ACCOUNTING—CHANGE OF METHOD—PERMISSIBILITY—MERCANTILE SYSTEM—UNPAID DEBTS, WHETHER ASSESSABLE AS PROFITS OR GAINS—REFERENCE—COSTS—DEPOSIT OF RS. 100—ORDER DIRECTING ASSESSEE TO PAY COSTS—PROPER FORM—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 13.

The assessee was a firm which was acting as selling agents of a Spinning and Weaving Company and was entitled under the terms of the agency agreement to a commission on goods sold on behalf of the Company. The system of accounting adopted by the assessee was the mercantile system. For the accounting year which ended 31st December 1933 assessee showed the commission earned down

to 30th June 1933, which had been paid to it, but did not show the commission earned from 1st July to 31st December 1933, on the ground that the Company had got into financial difficulties and the assessee feared that this commission may not be paid at all. The assessee contended that it was not bound to include this commission until it was received by it: Held, *upholding the view of the income tax authorities, that in view of the system of accounting regularly adopted by the assessee, the assessee was bound to include the commission earned from July 1 to December 31, 1933, and could rightly be assessed in respect of it.*

Though it is open to an assessee to change the regular basis on which he keeps accounts, still if he seeks to do so he must satisfy the income tax authorities on proper evidence that he has in fact changed the regular basis of accounting. The basis of accounting cannot be changed for a particular half-year alone.

Since the deposit of Rs. 100 paid by an assessee under Sec. 66 (2) is part of the assessee's costs of the reference, the proper order to make where the assessee is directed to pay costs and there is nothing to suggest that the application was improper or frivolous, is that the assessee should pay the costs less the Rs. 100.

Though an unpaid debt is not an income, it may be profits or gains if it is treated as profits or gains in the system of accounting adopted by the assessee.

St. Lucia Usines and Estates Co. v. *St. Lucia Colonial Treasurer* [*1924 A. C. 508*] distinguished.

Case stated under S. 66 (2) of the Indian Income Tax Act (XI of 1922) by the Commissioner of Income Tax, Bombay, (Civil Reference No. 10 of 1935).

STATEMENT OF CASE.

Under S. 66 (2) of the Indian Income Tax Act, XI of 1922, (hereinafter referred to as "the Act") and at the instance of Messrs. Ramakumar Kedarnath of Bombay, (hereinafter referred to as "the assessees"), I have the honour to refer for favour of your Lordships' decision the question of law set out in paragraph 5 below which has arisen out of the income-tax assessment of the assessees for the financial year 1934-35 (ended 31st March 1935).

2. **Facts of the case.**—By an agreement dated tha 13th January 1930 between the assessees and the Morarji Goculdas Spinning and Weaving Co. Ltd., the former were appointed the selling agents of the latter company for a period of one year certain. This agreement was subsequently extended and it was in

operation during the accounting period now in question. Under paragraph 8 of this deed, the assessees were entitled to a commission of 2 per cent. on fancy dyed and bleached goods and 1 per cent. on grey goods sold through them. By clause 11 the commission was made payable every six months when the accounts of the Company were made up and duly audited. A copy of the said agreement is annexed hereto and is marked Ex. A. The assessees had also been working as selling agents for the same Company prior to this agreement.

3. For the purposes of their income-tax assessment for the financial year ended 31st March 1937, the assessees were called upon by the Income Tax Officer C-I Ward Bombay, to furnish their return of income for the "previous year" as defined in Section 2 (11) of the Act, *viz.*, for the calendar year ended 31st December 1933. The assessees sent in their return on 18th July 1934 declaring therein an income of Rs. 33,550 supported by a statement prepared by their accountants from the Profit and Loss Account in their account books. The statement above referred to included receipts from commission for the six months ended June 1933 only. The practice of the assessees in the past being to declare commission accrued due up to 31st December, the Income-Tax Officer called upon them to explain the omission in respect of the commission for the six months ended 31st December 1933. The accountants who represented the assessees were unable to give any satisfactory explanation and the Income Tax Officer therefore added the figure of Rs. 38,965 to the income declared by the assessee as representing commission accrued due for the above period. A copy of his Assessment Order dated 23rd November, 1934, is annexed hereto and marked Ex. B. Against this assessment there was an appeal to the Assistant Commissioner and the grounds of the appeal were that as the Mills from which the said income of Rs. 38,965 accrued had closed down in 1933 owing to financial difficulties the payment of the commission for the half year ended 31st December, 1933, was a matter of grave doubt and as such it was not accounted for as usual in the books for the calendar year ended 31st December, 1933. It was further contended that inasmuch as the sales on which commission was receivable were recorded by the mills, what had actually accrued was not known at the date of the accounting period. A copy of the petition of appeal is annexed heretc marked Ex. C. The Assistant Commissioner by his order dated 4th March 1935 (copy annexed hereto marked Ex. D.) confirmec

the assessment levied by the Income Tax Officer. In his order, the Assistant Commissioner has found as a fact that the allegation that what had accrued was not known at the date of the accounting period was untrue. He further held as a fact that the assessee's accounts had been maintained from year to year on the mercantile system, commission being entered on the dates on which it accrued irrespective of the date of payment. The mills started working again in 1934 and the above commission was in fact duly paid to the assessees in 1934.

4. Being dissatisfied with the above decision, the assessees have asked me to refer the case to your Lordships under S. 66 (2) of the Act. Accordingly, I submit this statement of the case.

5. Question for the decision of the Honourable High Court. The following question of law arises in the case: "Whether in view of the provisions of S. 13 of the Indian Income Tax Act, the Income Tax Officer has correctly included, in the computation of income for the calendar year ended 31st December 1933, the sum of Rs. 38,965 on account of commission for the six months ended 31st December 1933".

6. **Opinion of the Commissioner.**—As Section 66 (2) of the Act requires me to give my opinion while submitting the statement of the case, I beg to add that Section 13 (1) of the Act makes it incumbent on the Income Tax Officer to compute income, profits and gains for the purposes of Sections 10, 11 and 12 of the Act "in accordance with the method of accounting regularly employed by the assessees." This is the case of income liable under the head "Business" to which S. 10 applies. Hence the Income Tax Officer was bound to compute the income in accordance with the method of accounting regularly employed by the assessee. That method was the mercantile method of accountancy under which income is accounted for as it accrues and the assessees should have, in accordance with their previous practice included the income from commission which accrued for the six months ended 31st December 1933. The Income Tax Officer was thus quite correct in taking into account this income which accrued during the "previous year" of the assessees for the purposes of this assessment, *viz.*, the calendar year, 1933. I would therefore answer the question in the affirmative.

7. A copy of your Lordships' decision may kindly be certified to me for further action as required by Section 66 (5) of the Act."

The *Advocate-General* with the *Government Solicitor* for the Commissioner.

Sir J. B. *Kanga* with Messrs. *Motichand and Devidas* for the Assessee.

JUDGMENT.

BEAUMONT, C. J. :—This is a reference made by the Commissioner of Income Tax under S. 66 (2) of the Indian Income Tax Act, XI of 1922, and the question he raises is :—" Whether in view of the provisions of S. 13 of the Indian Income Tax Act, the Income Tax Officer has correctly included, in the computation of income for the calendar year ended 31st December, 1933, the sum of Rs. 38,965 on account of commission for the six months ended 31st December 1933."

The assessee was a firm, which was acting as selling agents for a company known as Morarji Goculdas Spinning and Weaving Co. Ltd. under an agreement dated the 13th of January 1930, which is Ex. A. Under that agreement the firm got commission on goods which it sold on behalf of the company, and also on goods which the company sold directly to up-country dealers. The system of accounting adopted by the firm was the method which is known as the mercantile method, that is to say, it accounted on the basis of commission earned, and not on the basis of commission actually paid. That system prevailed down to the accounting period ended the 31st December, 1932. For the accounting period ended 31st December 1933, which is the accounting period in question in this case, the asseesee showed the commission earned down to the 30th of June 1933, that commission having been paid during the accounting period but showed no commission earned for the half year ended 31st of December 1933, because the Company had got into financial difficulties, and the assessee thought it very possible that the commission would not in fact be received. Subsequently the company was reinstated and the commission earned was in fact paid after the 31st December 1933. The Commissioner says that having regard to Section 13 of the Income Tax Act which directs that income, profits and gains shall be computed for the purpose of, among other sections, S. 10, which is the section dealing with business, in accordance with the method of accounting regularly employed by the assessee was bound to include the income from commission earned during the half year ended 31st December, 1933. The assessee, on the other hand says that he was not bound to include that commission in the accounting year because he had not received it, although he admits that he was bound to include it in the year in which he did receive it.

The assessee relies on a decision of the Privy Council in the case of *St. Lucia Usines and Estates Co. v. St. Lucia Colonial Treasurer* (1924 A.C. 508). That case establishes that money earned, which constitutes a debt, is not income, and that a debt accrued is not income accrued, but there is nothing in the case to show that the Income Tax Ordinance, which fell to be construed by the Board, contained the words "income, profits and gains." At any rate, the only word with which the Privy Council were concerned in that case was the word income. They were dealing with an assessee who had not got a business but was entitled to interest on a single sum; so that the only question was whether interest which had been earned but was not paid amounted to income, and the Privy Council held that it did not. Although an unpaid debt is not an income, it may be—as it seems to me—profits or gains, if it is treated as profits or gains in the system of accounting adopted by the assessee.

On the whole, I think the contention of the Income Tax Commissioner is right. The assessee had undoubtedly kept his accounts regularly on the mercantile basis. He could consistently with that basis have shown the commission earned for the half year ended the 31st of December 1933, and as against that shown as a debit item, the same amount as a bad debt, and if the Commissioner had been satisfied that in fact the debt was bad, he would have allowed the debt; if he had not been satisfied and had charged income tax on the debt, and such debt was ultimately never received, I think the assessee would have been entitled to claim a refund under S. 48 A. Here undoubtedly the assessee was trying to alter the basis of accounting from the mercantile basis to a cash basis for this particular half year, and in my view no case is established which justified him in doing that. Although I think it is open to an assessee to change the regular basis on which he keeps accounts, still if he seeks to do that he must satisfy the Commissioner on proper evidence that he has in fact changed the regular basis of accounting. I do not think here he did in fact change the regular basis of accounting except for this particular half year; and if the company had been reinstated again and had continued the agency agreement as before, there is nothing to show that the basis on which the accounts had been kept in the past would not have been continued in future.

In my view, therefore, we ought to answer the question in the affirmative. Costs to be paid by the assessee on the Original Side scale.

With regard to the costs, we held yesterday (judgment reported as *Gopal Vajinath Manohar* v. *Commissioner of Income-Tax, Bombay*, 4 I.T.R. 417) that the deposit paid under S. 66 (2) is part of the assessee's costs of the reference. In the present case the assessee is ordered to pay the costs on the Original Side scale, in accordance with the ordinary practice. But now that the position of the deposit of Rs. 100 has been brought to our attention, I think the proper order to make, where the assessee is directed to pay costs and there is nothing to suggest that the application was improper or frivolous, is that the assessee should pay the costs on the Original Side scale, less Rs. 100.

RANGNEKAR, J.—I agree.

[IN THE NAGPUR HIGH COURT.]

CENTRAL INDIA SPINNING, WEAVING AND MANUFACTURING CO., LTD. (EMPRESS MILLS)

v.

COMMISSIONER OF INCOME-TAX, U. P. and C. P.

STONE, C. J., and NIYOGI, J.

November 30, 1947.

REFERENCE—APPLICATION TO REQUIRE COMMISSIONER TO STATE CASE—NOTICE TO SHOW CAUSE, NECESSITY OF—ORDER REJECTING APPLICATION FOR REVISION—REFERENCE TO HIGH COURT, WHETHER COMPETENT—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 66 (2).

It is the practice of the Nagpur High Court, when ex parte applications are made to the High Court asking the Court to call upon the Commissioner of Income Tax to show cause why a case should not be stated, either to dismiss the application or, if it is entertained, to give notice to the other side to show cause.

Where the Commissioner of Income Tax, acting under Section 33 refuses to review the order of an Assistant Commissioner, the position of the assessee not being altered as a consequence, the assessee is not prejudiced within the meaning of Sec. 66 (2) and an application for reference is incompetent.

The true intent of the first proviso to Sec. 66 (2) is that a question of law that is common to both the Assistant Commissioner's order and the Commissioner's order is not a proper subject matter of reference unless that question of law is raised on a reference from the decision of the Assistant Commissioner.

N. A. S. Venkatachalam Chettiar v. *Commissioner of Income-Tax, Madras [1935] (1935 I.T.R. 55; 58 Mad. 363; 156 I.C. 64; A.I.R. 1935 Mad. 387)* followed.

Misc. J. C. No. 89 of 1935, decided on 30th November 1936.

A. V. Khare, for Applicant.

D. N. Chaudhary, for Commissioner.

ORDER.

STONE, C. J.—This matter comes before us in a somewhat irregular way owing, it would seem, to a clerical slip on the part of a Reader in the conclusion of the *ex parte* application which was moved on 1st February 1935, the order upon which was noted in the following words: Notice to Commissioner of Income tax to state the case." It is the practice of this High Court, and was the practice of the Judicial Commissioner's Court, when *ex parte* applications were made to the Court asking the Court to call upon the Commissioner of Income tax to show cause why a case should not be stated, for the Court either to dismiss the application, or if it entertained it, to give notice to the other side to show cause and it must be that the learned Judicial Commissioner who passed the order in question intended that the Commissioner was given notice to show cause. Otherwise the use of the word 'notice' is meaningless. We have accordingly treated this matter as one arising on such notice being given, and have consequently considered whether this is a case in which the Commissioner should be ordered to state a case on a particular point of law which, had we decided that the Commissioner should be called upon to state a case, would then have been argued before us.

The question is covered by the decision of a Bench of the Madras High Court in *Venkatachalam Chettiar* v. *Commissioner of Income-tax, Madras*. It can be stated as follows: The scheme of Ss. 30, 31, 32, 33 and 66, Income-tax Act, appears to be as follows: An assessment having been made under S. 30 an appeal lies at the instance of the assessee to the Assistant Commissioner. The Assistant Commissioner having heard the appeal according to the provisions of S. 31 gave his order as provided by that section, and from that order, or from an order passed under S. 28, an appeal lies in certain cases, and in certain cases only,

under the provisions of S. 32. It is common ground that the present is not such a case so that the matter here in dispute was finally decided by the Assistant Commissioner subject to two rights possessed by the assessee: the one is under S. 33, the other is under S. 66.

Section 33 which in terms is a section empowering the Commissioner to act *suo motu* is in practice a section used by assessees as the foundation for application to be made to the Commissioner to review orders passed by an Assistant Commissioner. That practice was pursued here. The same arguments were advanced by the assessee before the Assistant Commissioner and the Commissioner; different reasons were given by those two officers for the same conclusion. The result therefore was that the review was refused. The result of that was that the assessee was left in the same position as he was after the Assistant Commissioner's order had been passed save that he had no further right to go in review to any other authority unless he retains the right to refer to the High Court under S. 66. S. 66 gives him a right to have the matter referred to the High Court within a given time, where the order that he is complaining of is an order of a particular kind made under S. 33. The words of the Section [S. 66 (2)] are: "an order under S. 33 enhancing an assessment or otherwise prejudicial to him."

In such a case there is a power to require a point of law to be referred, subject to certain provisions of which the material one here is as follows:

"Provided that a reference shall lie from an order under S. 33 only on a question of law arising out of that order itself, and not on a question of law arising out of a previous order under S. 31 or S. 32, revised by the order under S. 33."

Venkatachalam Chettiar v. *Commissioner of Income tax, Madras*, decided that where the Commissioner operating under S. 33 refuses to review the order of the Assistant Commissioner the position of the assessee not being altered as a consequence, the assessee is not prejudiced. Bearing in mind the fact that the Assistant Commissioner is the final Court of appeal in cases such as the present we respectfully agree with that conclusion. Further in this case, in our opinion, there is another difficulty in the assessee's way, because although the Commissioner decided more points of law than the Assistant Commissioner decided, both decided a coincident point of law, and it is common ground that the point being decided as it was, it concludes the matter against the

assessee and the other points do not arise. Thus, one has here a decision on a question of law that did not merely arise out of the order itself but also arose out of the previous order. It is true that in this case the previous order was not revised by the order under S. 33; but our present impression is that the true intent of the first proviso to the second sub-Section of S. 66 is that a question of law that is common to both Assistant Commissioner's and the Commissioner's order is not a proper subject-matter of a reference unless the question of law is raised on a reference from the decision of the Assistant Commissioner which is not the case here. However, our attention has been drawn to a letter which the assessees received from the income tax authorities which, in our opinion, invited some sort of a reference to that made in this matter.

The application is accordingly dismissed but we fix the costs at Rs. 50 only.

Application dismissed.

[IN THE PRIVY COUNCIL.]

Appeal from the Bombay High Court.

THE INDIAN RADIO AND CABLE COMMUNICATIONS COMPANY, LTD. *v.* THE COMMISSIONER OF INCOME TAX, BOMBAY PRESIDENCY & ADEN.

LORD MAUGHAM, SIR SHADILAL and SIR GEORGE RANKIN.

April 8, 1937.

BUSINESS EXPENDITURE—PAYMENT OUT OF PROFITS—AMALGAMATION OF BUSINESS OF TWO COMPANIES—SHARE OF PROFITS PAID BY ONE COMPANY TO THE OTHER, WHETHER ALLOWABLE AS BUSINESS EXPENDITURE—LEASE AND JOINT ADVENTURE DISTINGUISHED—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 10 (2) (ix).

The appellant company carried on in India the business of communication by wireless, whilst another company (the Communications Company) controlled two companies which carried on in

India the business of communication by cable. The two businesses being to a certain extent competitive, the appellant company and the Communications Company entered into an agreement to the effect that their businesses in India should be combined and conducted by the appellant company for a certain number of years. The Communications Company agreed to deliver all the plant, machinery, fittings etc. of their business in India to the appellant company to be used by the latter during the period of the agreement and the latter agreed to pay one-half of its net profits for each of its financial years to the Communications Company: Held, *affirming the judgment of the Bombay High Court, that the half share of the net profits payable by the appellant company to the Communications Company under this agreement was not of the nature of rent, but was in truth payable as part of the consideration in respect of a number of different advantages which the appellants derived from the agreement; the agreement was more like one of a joint adventure for a term of years than a lease and the share of the profits thus paid by the appellant company was therefore not allowable as expenditure incurred solely for earning profits, in assessing the income of the appellant company for purposes of income-tax.*

Dictum: *It is not universally true to say that a payment the making of which is conditional on profits being earned cannot properly be described as an expenditure incurred for the purpose of earning such profits. The typical exception is that of a payment to a director or manager of a commission on the profits of a company.*

Difficulty may often exist in deciding whether expenditure not in the nature of capital expenditure has been incurred solely for the purpose of making or earning income, profits or gains and it may be impossible to formulate a test which may always suffice to discriminate between the expenditure which is and which is not allowable for the purpose of income-tax.

Judment of the Bombay High Court in Indian Radio & Cable Communications Ltd. v. *Commissioner of Income Tax, Bombay* (1936) (1936 I.T.R. 90; 8 I.T.C. 233) *affirmed.*

PONDICHERRY RAILWAY CO. *v.* COMMISSIONER OF INCOME TAX, MADRAS (1931) 58 I.A. 239; 54 Mad. 691; 132 I. C. 619; A.I.R. 1931 P. C. 165; 35 C.W.N. 895) explained.

ADAMSON *v.* UNION COLD STORAGE COMPANY (1931) (16 Tax Cas. 293; 146 L.T. 172) referred to.

A. M. Latter, K. C., and *J. S. Scrimgeour*, for the Appellants.

A. M. Dunne, K. C., and *H. Hill*, for the respondent.

JUDGMENT.

LORD MAUGHAM.—This is an appeal from a judgment and order of the High Court of Judicature at Bombay, dated March 28, 1935, whereby the High Court, upon the hearing of a case referred to it by the respondent under the provisions of S. 66 (2) of the Indian Income Tax Act, 1922 (XI of 1922) (referred to below as " the Act "), answered the question of law raised thereby adversely to the contention of the appellant company.

The question of law referred to the High Court arose in the course of the assessment of the income of the appellant company chargeable with income tax and super tax for the year of assessment ending on March 31, 1934, and was as follows:

" Whether the half share of the net profits, payable by the assessee company " (meaning the appellant company) " under Cl. 5 of the Agreement, dated the 19th day of February 1932, *viz.*, Rs. 3,35,861, is a proper deduction to be allowed for the purposes of arriving at the amount on which this company should be assessed for the purposes of income-tax and super-tax, within the meaning of S. 10 (2) (*ix*)."

It should be added that the material sub-section of the Indian Income Tax Act, 1922, is S. 12 (2), which, after providing that the tax shall be payable under the head " other sources " in respect of income, profits and gains of every kind, enacts as follows:

" Such income, profits and gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains, provided that no allowance shall be made on account of any personal expenses of the assessee."

The appellant company is incorporated and registered in Bombay under the Indian Companies Act, 1913. Prior to the date of the agreement of 1932, out of which the present problem arises, the appellant company carried on in India the business of communication by wireless, whilst a company known as the Imperial and International Communications Ltd. (whom it will be convenient to call the Communications Company), owned or controlled two companies called the Eastern Telegraph Company Ltd., and the Eastern Extension Australasia and China Telegraph Company Ltd., which carried on the business and undertaking in India of communication by cable. The radio business of the

appellant company and the cable business in India of the undertaking of the two companies controlled by the Communications Company (called below the combined undertaking) were to a certain extent, competitive, a circumstance which led to the agreement next to be stated. The Communications Company held not less than half the issued share capital of the appellant company, which no doubt facilitated the negotiation of the terms.

By the agreement which was dated February 19, 1932, and made between the Communications Company and the appellants, it was recited that the parties had agreed that the future operation and control of the business in India of the combined undertaking could be conducted more conveniently and to their mutual advantage if possession of the combined undertaking was given to the appellants and the business was conducted by the appellants in connection with their wireless undertaking.

By Cl. 3 it was provided that (subject to certain conditions precedent which were satisfied) the Communications Company should, on the date to be appointed, deliver to or otherwise place the appellants in possession for the purposes of the agreement of all plant, machinery, instruments and apparatus, fittings, furniture, stationery and stores (hereinafter referred to as "the plant") at Bombay and Madras owned or held by the Communications Company in connection with the business in India of the combined undertaking, and from the appointed date the appellants were authorised to use the plant for the purpose of carrying on and conducting for the period of the agreement the business in India of the combined undertaking (exclusive of the Karachi business as defined in the agreement) in conjunction with the wireless undertaking of the appellants.

Clause 4 provided that the agreement should determine on December 31, 1944, or earlier on notice given by either party that they were ceasing to carry on business.

The consideration to be paid by the appellants under the agreement was set out in Cl. 5 in the following terms:—

"The Radio Company shall as and from the appointed date pay to the Communications Company :—

(*a*) The sum of Pounds ninety thousand sterling which represents an assessment of the expenses proportionate to the traffic of the combined undertaking emanating in India exclusive of the Karachi business, of the maintenance by the Communications Company of its communications system throughout the world exclusive of India. The said sum shall be payable by four

equal quarterly instalments on the thirty-first March, the thirtieth June, the thirtieth September, and the thirty-first December in each year and each instalment shall be remitted to London by and at the expense of the Radio Company within six weeks after the date on which the same shall become payable.

(b) One-half of the net profits of the Radio Company for each of its financial years which shall be payable to or at the direction of the Communications Company and paid in Rupees in Bombay as follows:—

(1) As to eighty per cent. thereof by such payments on account from time to time as the Board of Directors of the Radio Company shall consider that finances of the Radio Company justify.

(2) As to the balance thereof within fourteen days after the date on which the Balance Sheet and Profit and Loss Account of the Radio Company for such financial year shall have been passed and adopted by the shareholders of the Radio Company at their Annual General Meeting. Provided that if the aggregate of such payments on account shall exceed the actual amount of the half share in the net profits of the Radio Company as finally ascertained for such financial year the excess paid shall be refunded by the Communications Company to the Radio Company on demand.

For the purpose of sub-Cl. (b) of this clause the expression 'net profits' means the profits for each year remaining after deducting from the gross revenue of the Radio Company from all sources (except as hereinafter mentioned) the aggregate amount of all terminal and transit charges payable to Government and other administrations and Telegraph Companies, Royalty payable to the Government of India, and all ordinary expenses in connection with the entire undertaking properly chargeable to revenue and depreciation at the usual rates hitherto adopted by the Radio Company but before making any allowance for income tax and before placing any sum to Reserve.

Provided—

"(1) That the sum of pounds ninety thousand sterling payable under sub-Cl. (a) of this clause shall be treated for the purpose of this clause as an ordinary expense in connection with the undertaking properly chargeable to Revenue.

(2) That if Government shall levy from the Radio Company income tax on the half share of the net profits payable to the Communications Company under sub-Cl. (b) of this clause the

Radio Company shall be entitled to deduct the amount of the tax so levied and paid from the share of the Communications Company in the net profits of the Radio Company before payment of that share to the Communications Company.

(3) That in ascertaining the annual gross revenue of the Radio Company from all sources income derived from investments made by the Radio Company by way of Reserve Fund or any other fund established out of profits shall be excluded from such Revenue.

(4) That all accounts shall be kept and payments made in Rupees except the said sum of Pounds ninety thousand which shall be payable and paid in sterling."

There were a number of other provisions of which the following are the most important for the present purpose.

By Cl. 6 the Communications Company guaranteed that the plant referred to in Cl. 3 thereof should be handed over in good working order to the satisfaction of the chief engineer of the appellant company.

By Cl. 7 (a) the Communications Company undertook:

"so to uphold and maintain the Communications including cables, land lines and radio services from time to time belonging to it outside India and shore ends and cable-connections therefrom to the cable offices in Bombay and Madras as to keep its system in good working order and up to the standard of efficiency required for fast communications, act of God, Governments and peoples, civil commotions, strikes and lockouts alone excepted."

(b) The Communications Company were:

"to permit the appellant Company to receive and retain the total receipts derived from the cable and wireless traffic emanating in India, less rebates and outpayments to other administrations and companies, save and except receipts derived from cable traffic for the Persian Gulf and Iraq only entrusted to the Communications Company by the Indian Government Telegraph Department at Karachi."

By (d) the parties agreed that during the period of the agreement there should be the closest co-operation between them in the conduct of the business of their respective undertakings in so far as they related to communication with and through India and so also that the control of the said business of wireless in India and of the combined undertaking in India (exclusive as aforesaid) should be conducted by the appellant company free from interference by the Communications Company.

By (e) if during the period of this agreement the appellant company should duly perform and observe the stipulations on its part herein contained, the Communications Company would allow the appellant Company for the purposes of the agreement to use, hold and enjoy the plant and other premises delivered and transferred to it by the Communications Company free from any interference or disturbance by or on behalf of the Communications Company: provided, however, that if any of the said plant or premises should become unnecessary for the purpose of the cable business to be carried on by the appellant company, that company would hold and dispose of the same under the directions and on behalf of the Communications Company.

There followed provisions imposing on the appellant company obligations to carry on the business in India of the combined undertaking to the best possible advantage, to maintain the plant transferred to it in satisfactory condition and repair, to renew the plant when necessary, to insure, and to hand over the same and any renewals to the Communications Company in satisfactory condition and repair at the determination of the agreement. The appellant company was to permit the Communications Company to receive and retain the total receipts derived from the cable and wireless traffic of the Communications Company and its subsidiaries, including the combined undertaking emanating at any place outside of India and also the receipts derived from cable and wireless traffic for the Persian Gulf and Iraq entrusted to the Communications Company by the Indian Government Telegraph Department at Karachi, less refunds, rebates to Governments and outpayments to other administrations and companies.

Clause 11 provided that the Communications Company should forthwith after the appointed date execute in favour of the appellant company (a) an underlease of certain premises whereof the Communications Company were the lessees, for a term expiring on December 31, 1934, and at a rent equal to that payable under the lease held by the Communications Company, and (b) a lease of certain premises at Madras whereof the Communications Company were the owners for a term expiring on the said December 31, 1944, at a nominal rent, the said underlease and lease to contain clauses enabling the Communications Company to re-enter upon the premises the subject thereof upon the termination of the said agreement.

In pursuance of the agreement possession of the plant and

premises of the combined undertaking was given to the appellants.

For the year 1933-34 ended March 31, 1934, the appellants were assessed by the Income-tax Officer of the Companies Circle, Bombay, to income tax on a total income of Rs. 18,86,366 derived from business and securities. The only question now in dispute with regard to the assessment is whether in computing the profits of the appellants' business the appellants were entitled to deduct the sum payable to the Communications Company under cl. 5 (b) of the agreement, namely, one half of the net profits of the appellants for the financial year in question, which was stated to amount to Rs. 3,35,861. (The deduction of the £90,000 payable under cl. 5 (a) was allowed).

The Income tax Officer having refused to allow the said payment as a deduction, the appellants appealed to the Assistant Commissioner of Income tax, who by his order dated February 22, 1934, held that the said deduction had been correctly disallowed.

The appellants thereupon required the Commissioner of Income tax to draw up a statement of the case and refer it with his opinion thereon to the High Court of Judicature at Bombay. The question above set out was accordingly referred to the High Court. The learned Judges held that the question so referred must be answered in the negative. In that Court as before their Lordships, the contention was that the one-half of the net profits of the appellants for the year in question was in the nature of rent payable under the agreement for the right to use the plant of the Communications Company in connection with the cable business in India of the combined undertaking. The CHIEF JUSTICE and RANGNEKAR, J., declined to accept that contention.

Their Lordships have had the advantage of a learned argument on behalf of the appellants; but they have found themselves unable to come to a conclusion different from that of the High Court. It may be admitted that, as Mr. Latter contended, it is not universally true to say that a payment the making of which is conditional on profits being earned cannot properly be described as an expenditure incurred for the purpose of earning such profits. The typical exception is that of a payment to a director or a manager of a commission on the profits of a company. It may, however, be worth pointing out that an apparent difficulty here is really caused by using the word "profits" in more than one sense. If a company having made an apparent net profit of

£10,000 has then to pay £1,000 to directors or managers as the contractual recompense for their service during the year, it is plain that the real net profit is only £9,000. A contract to pay a commission at 10 per cent. on the net profits of the year must necessarily be held to mean on the net profits before the deduction of the commission, that is, in the case supposed, a commission on the £10,000.

Their Lordships do not think that there is in the present case any sufficient ground for holding that the sum in question is of the nature of a rent. It is neither described as a rent, nor does the agreement contain several of the clauses which a lease of plant of such a character would naturally contain. Circumstances of greater importance are that the sum payable may be small or great or nothing—a most unusual feature in the case of rent—and that it is impossible to presume or infer that the half share of profits is being paid only as rent, or as a similar payment, in consideration merely of the use of the plant the subject of the license in Cl. 3 of the agreement. The sum is in truth made payable as part of the consideration in respect of a number of different advantages which the appellants derive from the agreement and not all of them can be shown to be of a purely temporary character. The agreement as a whole is much more like one for a joint adventure for a term of years between the appellant company and the Communications Company than one for a lease for that period. Speaking generally, receipts in respect of business emanating from abroad are to be retained by the Communications Company while receipts arising in India are to be retained by the appellants and that irrespective of whether the messages are sent by cable or by wireless; and the net profits of the appellant company are to be divided. Nor is it wholly immaterial to note that at the date of the agreement the appellant company was, and that it apparently still is, in some measure controlled by the Communications Company.

Their Lordships recognise the difficulty which may often exist in deciding whether expenditure not in the nature of capital expenditure has been incurred solely for the purpose of making or earning "income, profits or gains" and they agree that it may be impossible to formulate a test which will always suffice to discriminate between the expenditure which is and which is not allowable for the purpose of income tax; but in the present case they have little hesitation in coming to the conclusion that the proposed deduction is not allowable. To avoid misconception

it is proper to say that in coming to this conclusion they have not taken the view that the case is governed by the decision in *Pondicherry Railway Co., Ltd.* v. *Commissioner of Income Tax, Madras,* though that case no doubt throws light on the nature of the problem which has to be solved in the present case. It should perhaps be added that a sentence in the judgment in that case, has been explained, if explanation was necessary, by LORD MACMILLAN in the subsequent case of *W. H. E. Adamson* v. *Union Cold Storage Company.*

For the reasons above stated their Lordships will humbly advise His Majesty that the appeal should be dismissed with costs.

Appeal dismissed.

[IN THE LAHORE HIGH COURT.]

THE B. C. G. A. (PUNJAB), LTD.

v.

THE COMMISSIONER OF INCOME TAX, PUNJAB.

MONROE, BHIDE and DIN MOHAMMAD, JJ.

February, 26, 1937.

INTEREST—MERCANTILE SYSTEM—ASSESSMENT OF UNREALISED INTEREST—ENTRY OF INTEREST IN SUSPENSE ACCOUNT—EFFECT—FIRM—SHARING IN PROFITS BUT NOT LOSS, WHETHER CONSTITUTES PARTNERSHIP—SEVERAL BUSINESSES—LOSS IN DISCONTINUED BUSINESS CANNOT BE SET OFF AGAINST PROFITS OF RUNNING BUSINESS—BAD DEBT—TESTS—LIMITATION TEST, VALUE OF—DEBT IN PROCESS OF BEING REALISED, WHETHER CAN BE TREATED AS BAD—FINDING AS TO BAD DEBT—INTERFERENCE—PRINCIPLES—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 10, 24, 66 (2)—INDIAN PARTNERSHIP ACT (1932), SEC. 4.

The mortgagee of a factory who had agreed to appropriate the profits of the factory towards the mortgage loan made a profit of Rs. 90,000. He appropriated this sum towards the total mortgage amount and debited the mortgagors with the balance of the mortgage amount, viz., *Rs. 68,365. This balance included Rs. 12,447 on account of interest, which, after being entered in the mortgagor's account, was taken to suspense account and thus*

excluded from the profits. The mortgagee kept his account in the mercantile system and had only on one previous occasion transferred a similar item to the suspense account. Held, *that the only question for judicial determination on these facts was whether there was any evidence before the income tax authorities upon which they might find that the appellant's system of accounting required the inclusion in his accounts of this item of Rs. 12,447 : that the solitary previous instance was not enough to establish that the exclusion of this item was based on any system adopted by the assessee or that that system was regular; and that upon the assessee's own admission that the crediting to the suspense account was not based on any regular system, the assessee was bound to include this sum in the computation of his profits ;* Held, *further, that as the assessee had adopted the mercantile system and this amount of interest was entered in the accounts as money received like other interest entries, it was liable to be assessed to income tax even though it was not under his control in such a way as to be convertible to cash at any time.*

The mere circumstance that a person is to share profits only and not losses does not by itself militate against the existence of partnership.

An assessee cannot set off the losses of a business which had been discontinued before the year of account against the profits and gains of a current business. It is a condition precedent to the right of set-off that both businesses should be alive during the current year. South Indian Industrials *v.* Commissioner of Income Tax, Madras (1935 I.T.R. 11) *followed.*

When the income tax authorities find that a debt had become bad in a particular year the only thing open to the High Court is to determine whether the finding arrived at by them is vitiated on any ground, or in other words, is perverse or unwarranted by the material on the record. If it is found that the finding is based or relevant and admissible evidence interference is barred. Where certain debts were shown under the head 'bad and doubtful debts' in 1933 and the assessee claimed them as bad debts in the year 1935-36 on the ground that the debts became time barred in this year but the Income tax authorities held that the debts had become bad in 1933 : Held *that the High Court had no power to interfere with the finding.*

So long as there is any ray of hope left to recover a debt, however dim it may be, and so long as a debt is in the process of realisation it cannot be said that it has become irrecoverable.

Cases referred to:

ARUNACHALAM CHETTIAR v. COMMISSIONER OF INCOME TAX, MADRAS [1936] (63 I.A. 233; I.L.R. 59 Mad. 716; 102 I.C. 1; A.I.R. 1936 P.C. 133; 1936 I.T.R. 173).

BADELEY v. CONSOLIDATED BANK [1888] (38 Ch. D. 238; 57 L.J. Ch. 468; 59 L.T. 419; 36 W.R. 745).

COMMISSIONER OF INCOME TAX, C.P. & BERAR v. CHITNAVIS [1932] (59 I.A. 290; 6 I.T.C. 453; 28 N.L.R. 205; 137 I.C. 772; A.I.R. 1932 P.C. 178).

COMMISSIONER OF INCOME TAX, C.P. & BERAR v. NANHELAL [1928] (3 I.T.C. 28; 24 N.L.R. 176; 111 I.C. 159; A.I.R. 1927 Mad. 1053; 2 I.T.C. 360).

COMMISSIONER OF INCOME TAX, MADRAS v. ARUNACHALAM CHETTIAR [1924] (I.L.R. 47 Mad. 660; 46 M.L.J. 68; 77 I.C. 772; A.I.R. 1924 Mad. 474; 1 I.T.C. 278).

COMMISSIONER OF INCOME TAX, MADRAS v. MOHAMMED KASIM ROWTHER [1927] (54 M.L.J. 210; 106 I.C. 308; A.I.R. 1927 Mad. 1053; 2 I.T.C. 482).

COMMISSIONER OF INCOME TAX, MADRAS v. SUBRAMANIAN CHETTIAR (1927) (I.L.R. 50 Mad. 766; 53 M.L.J. 379; 2 I.T.C. 365; 104 I.C. 645; A.I.R. 1927 Mad. 841).

F. E. DINSHAW v. COMMISSIONER OF INCOME TAX, BOMBAY (1934) (61 I.A. 318; I.L.R. 58 Bom. 579; 150 I.C. 806; A.I.R. 1934 P.C. 180; 1934 I.T.R. 519; 7 I.T.C. 360).

DURGA CHOWDHRANI v. JOWAHIR SINGH (1891) (17 I.A. 122; I.L.R. 18 Cal. 23; 8 Sar. 560).

FEROZ SHAH v. COMMISSIONER OF INCOME TAX, PUNJAB (1933) (60 I.A. 325; I.L.R. 14 Lah. 682; 144 I.C. 686; A.I.R. 1933 P.C. 198; 1933 I.T.R. 219; 7 I.T.C. 25).

V. S. A. R. FIRM v. COMMISSIONER OF INCOME TAX, BURMA (1935) (I.L.R. 13 Rang. 231; 8 I.T.C. 64; 156 I.C. 703; A.I.R. 1935 Rang. 109; 1935 I.T.R. 158).

JAGMANDAR DAS VAISH v. COMMISSIONER OF INCOME TAX, C.P. & U.P. (1935) (I.L.R. 57 All. 737; 8 I.T.C. 59; 1935 A.L.J. 374; 155 I.C. 939; A.I.R. 1935 All. 378; 1935 I.T.R. 140).

J. KESAVA RAO v. COMMISSIONER OF INCOME TAX (1936) (8 I.T.C. 217).

PANDURANG RAMACHANDRA v. COMMISSIONER OF INCOME TAX (1926) (91 I.C. 980; 2 I.T.C. 69; 21 N.L.R. 175; A.I.R. 1926 Nag. 180).

PITTAPUR v. SECRETARY OF STATE [1929] (56 I.A. 223; I.L.R. 52 Mad. 538; 117 I.C. 481: A.I.R. 1929 P.C. 152).

SECRETARY TO THE BOARD OF REVENUE, INCOME TAX, MADRAS v. ARUNACHALAM CHETTIAR [1921] (I.L.R. 44 Mad. 65; 39 M.L.J. 649; 59 I.C. 482; A.I.R. 1921 Mad. 427; 1 I.T.C. 75).

SOUTH INDIAN INDUSTRIALS, LTD. v. COMMISSIONER OF INCOME TAX, MADRAS [1935] (I.L.R. 58 Mad. 433; 8 I.T.C. 128; 68 M.L.J. 379; 157 I.C. 143; A.I.R. 1935 Mad. 330; 1935 I.T.R. 11).

Case stated by the Commissioner of Income Tax, Punjab N.W.F.P. and Delhi, under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922) in the matter of the assessment of the British Cotton Growers' Association (Punjab) Ltd. of Chanewal, District Multan, for the year 1935-36 [Civil Ref. No. 1 of 1937].

STATEMENT OF CASE.

"Case stated under Sec. 66 (2) of the Indian Income Tax Act, referring the questions of law arising out of the appeal of the assessee, the B.C.G.A. (Punjab) Ltd., against 1935-36 assessment.

2. Assessment was made determining total income Rs. 1,06,341 (previous year ending September 1934); and was appealed against on grounds which are copied in annexure A, together with relevant extracts from the Assessment order.

The appeal was rejected by orders, copied in Annexure B, and the assessee has required reference of the questions copied in the same Annexure.

The Questions which in the Commissioner's finding properly present the contentions of law arising, are contained within the Statement below.

An analysis of the accounts for the years ending September 1932, 1933 and 1934, is annexed (C).

3. The matters in issue are:—

(1) Question whether interest Rs. 12,447 charged on a debtor's balances and taken by the assessee to a suspense entry in the balance sheet, is assessable profit in accordance with the assessee's regular method of accounting.

(2), (3) and (4): Question whether debts of Rs. 1,78,052, Rs. 14,775, and Rs. 40,813, became in fact irrecoverable in the account period; and also whether the first of these items is in any event an accountable revenue item.

These matters required for their proper solution reference

to the prior history of account; and unfortunately this is not as clear in records as it should be. (As a convenient summary of the state of prior record, copy of the Commissioner's order on the 32-33 case is attached to the case, as an appendix). But there is enough in that prior history, together with the subject of the Sec. 34 addition to 32-33 assessment, and the under accounting of the non-agricultural income by the cross-transactions with the separate agricultural account. Appeal was laid on this matter, but withdrawn to suggest the need for dealing with the matters in issue strictly; and it appears desirable, before setting out the material, to explain the importance of any strict assignment of these items to the proper periods of account.

4. The Act lays charge upon the results of one year periods of account in isolation, without benefit of continuous adjustment in respect of losses: except only to the extent that "depreciation" if unabsorbed is allowed to be carried forward under Sec. 10 (2) (vi) Proviso (b). Thus if a particular loss can be brought out of a loss year, and put against a profit year, the charge laid by the Act can be reduced or avoided. (The graduated rate scale makes the same further true even of profit years in different grades. In the case of a Company this affects only the super tax amount.)

The assessments in this case have been (from the first assessment) :—

Assessment Year.	Assessed Profit or Loss Prior to depreciation allowance. Profit	Loss.	Depreciation allowance current.	Depreciation balance carried forward.	Nett Assessment.
24-25	20,777		No claim.		20,797
25-26	23,249		No claim.		23,249
26-27	1,47,435		24,588		1,22,847
27-28	82,119		26,875		55,244
28-29		??73,821	26,875	26,875	
29-30		??77,169	26,875	53,750	
30-31 Share in R. F.	18,441 24,314		26,911	37,906	
31-32 Share in R. F.	35,619 29,005		26,911	193	
32-33	Sec. 34 assessment. 1,01,083 1,863		28,104		74,639

33-34		15,152	28,104	28,104	
34-35		16,371	28,303	56,407	
35-36	1,91,047		28,299		106,341

*Default assessment under Section 23 (4).

It will be apparent what a great difference may be made by any improper allocation of losses, (or of profit attributions likewise). Section 13 makes the proper attribution of profits a fairly clear-cut question; but unfortunately the question of the date when a debt arrives at eventuated-irrecoverability is not so concrete, and there may be room for wide divergence of even unbiassed views.

Your Lordships have had before you cases where an assessee has claimed that such an event lay in one period; one officer has ascribed it to an earlier period: and another to a later. The commentator publishing "*Income Tax Reports*" (October 1936, page 52) has recently referred to the unsatisfactory position of the case law, in discussing Your Lordships' judgment in *Harnand Rai Harbhagat Rai* (32-33), dated 23-1-36. I would like to mention however that where there is any difference of attribution of this kind, it has been my practice in reliably accounted cases (unless there was special reason to the contrary) to give relief related to what would have been due had claim been made in any earlier year of badness found: or, where the claim has been found "premature," to direct that such finding shall automatically prolong the claim.

In the present case, the finding is that in any event the 1,78,052 item is not accountable. The 14,775 item will I think merit further examination in review, if Your Lordships' decision leaves it in issue, but I do not think any useful purpose would be served by taking further evidence about it and settling it finally at this stage. The 40,813 item will probably fall to be further examined in the subsequent assessment, but cannot on any footing (I think) be put in the present account.

General Statement.

5. The assessee is a company engaged in producing and merchanting cotton. It has more or less direct connections with various other concerns, principally a similarly named Manchester Company of which it appears to be a subsidiary; but the only notable point in this respect is that its accounts show (at present shares in half a score of cotton-concerns which appear to be more or less related as subsidiaries. There are other concerns with

which it has substantial credit accounts. Details are in notes (S) and (F) under Annexure C.

6. In circumstances already referred to, the only Balance Sheets in record are those obtained this year and digested in Annexure C.

The revenue accounts are in two sections, one headed "Farm", and the other "Factory". The Farm account deals mainly with the landed estate, leased mostly to cultivating tenants whose crop is largely purchased by the Company. Loans are also made to these tenants. The "Factory" account deals with both the factory-working, and the actual dealing in cotton.

The important points arising from past account are :—

(a) The only traceable Bad Debt write-offs are those in present account, and the small amount, shown in the prior year, (included in the annexure).

(b) As regards the taking of interest to suspense, I can find no previous reference; except one (which appears in the annexure) against year ending September 1933, which was not elucidated in the relevant assessment.

(c) As regards the account from which the 1,78,052 item arises ("Seeds Department") there are no earlier particulars to show (1) why the profit from that concern was not returned with the "Factory Account" in years when there were profits; or (2) how it was dealt within the earlier Balance Sheets: (*i.e.*, as between the heads, "Capital in Partnership" and "Current account with . . . . .")

It should be emphasized however, that all the issues are matters of claim—the Bad Debt claims essentially; and the Interest item, in the circumstances explained with *onus probandi* on the assessee claimant. If he has left any *lacunae* in his supporting evidence, that is a matter he can put before me under Section 23 of the Act; but your Lordships are not seized with the merits of the claims at large, only with the evidence placed by him before the authority whose findings lie in question.

7. *First issue.*

(*Facts*) The assessee had an extensive account with Wazir Chand Chaman Lal. The Balance Sheets details may be referred to in Annexure C, and compromise.

	Sept. 1932.	Sept. 1933.	Sept. 1934
Against mortgage of factory.	1,35,165	1,38,978	...
Against current account.	26,388	6,666	...

The Balance Sheets also include under "Current accounts":

Chistian Factory (owned by this debtor):	Nil	2,864	68,365

I can trace no other relevant account.

The Assessment Order (*Vide* Annexure B) details however five different accounts through which in the course of the year over 7 lakhs passed to credit. On these accounts a total of 12,447 was charged as interest during the year, and this is the sum in issue. The assessee instead of putting it to interest account (in Profit and Loss), put it to "Interest Suspense Account" in the Balance Sheet direct.

The Interest detail for account ending September 1932 includes Rs. 9,299 from this debtor duly credited to revenue account. (There is no detail statement for any other year).

There is no other material in record; but the present petition sets out that a loan was made in 1930, on mortgage with possession, of Rs. 1,50,000. During the present account, the assessee arranged to "finance the working", and to credit profits against the loan account. These credits were made; and as shown by the above Balance Sheet figures, they reduced the balance from 1.47 lakhs to 0.68 lakhs after charge of the interest as above. If this state of affairs had been brought into the appellate findings from which the issues before the Court must arise, the case would have lain much more onerously against the assessee: for it means that there were over 90,000 of *trading profits* carried to capital account; and the burden would have lain on him to justify the exclusion of the whole of these profits as such.

In an extremely careless assessment for 1934-35, the Income tax Officer overlooked a similar Interest Suspense credit, probably arising from the same accounts. Otherwise, it is not contested that the assessee's regular method of account is "Mercantile", and required normally that interest charged on debtors' accounts should be taken as an accountable receipt; and it is not suggested that there has been any regular practice of attribution to suspense. (The other suspense entries that do appear in the Balance Sheet are not explained, but appear to be normal suspense accounts and it is not suggested at any point that they have any bearing on the matter).

Although the audited accounts describe various items as doubtful, no such description has been attached to the present balance.

(*Opinion*) 8. There have been many cases on the question of interest accounted but not actually received in cash. Although the decisions have varied greatly it can I think be now taken as

concluded by your Lordships' decision in *Ahmad Din.* v. *Comm.* and likewise *J. Kesva Rao* v. *Comm.* (Madras) and *V.S.A.R. Firm* v. *Comm.* (Rangoon), that where there is a regular business, and a regular method of accounting it, what is in issue is no question of actual receipt, only of accountability within Section 13 of the Act.

I do not think the present matter then involves any question at all of appropriation of what certainly was received, between principal and interest. If it does, then the Privy Council in *Maharajadhiraj Kameshwar Singh of Darbhanga's* case (followed in such cases as *Gopi Ram Gobind Ram* Calcutta, 28-2-36) decided that there is a general presumption for attribution of receipts in open account to interest; but that the presumption no longer holds where the basis of that presumption (namely that attribution to interest is more favourable to the creditor) has been removed. In the circumstances, I think this would suggest that in the absence of any sort of proof, or even indication, that the balance is "bad", the due interest would have been attributable even out of open account. But as above, the debtor's account did actually include a computation of interest, its addition to balance and carrying forward of the nett balance.

All that I think lies in issue is the leading case about exceptional variation from regular course of account, which undoubtedly did *prima facie* require credit of this sum in revenue account. The Privy Council in *Mian Feroze Shah's* case held that where there was such exceptional variation, the essential question was "whether the appellant's system of accounting, by whatever name called, required the inclusion in his accounts of the sum referred to"; and "whether there was evidence on which the *proper authorities* could find that the item in issue was excluded from the accounts out of ordinary course and for reasons not to be justified."

9. I find the question properly arising to be:

(Question) "Has the assessee established justification for excluding the sum of 12,447 charged against Wazir Chand Chaman Lal from interest account (and crediting it to Suspense), out of ordinary course: by evidence so cogent that in issue of law it was impossible for the Assistant Commissioner to hold such justification not proved?"

In the Commissioner's opinion, no justification has even been propounded, let alone proved.

10. *Second Issue.*

(*Facts*): The share in a registered firm noted against 30-31

and 31-32 assessments in para. 4 above, was a two-third share in a separate partnership not returned by the assessee originally, but made the basis of a subsequent Section 48 claim (30-31 case). The firm name was given only as "Seeds Department."

It is difficult to reconcile this with the detail in the appellate order: (of two separate partnerships, of which the only one with specified share was four-fifths). As already noted, there is no record of how the share was originally accounted by the assessee* but in the available balance sheets a debit was brought forward, as a "Current Account", thus:—

	Sept. 1932.	Sept. 1933.	Sept. 1934.
"Seeds Department"	4,15,486	4,13,927	2,35,831

The Balance Sheet itself shows in 1934 a classification "Doubtful". There appears to have been a like comment in the Auditors' report on 1933 account. (The report itself is not in evidence: but this is asserted in the assessment order, and is not denied in petition).

*His returned accounts mentioned at least one payment (31-32) to that concern, as an "Expense".

The separate record of the assessment of the "Seeds Department" only makes the situation more confused. The only available record is one relating to "Seeds Department, Okara;" which was assessed for 30-31 (year ending September 1929) as an unregistered firm of

B. C. G. A.	5 shares	
Seeds Department, Khanewal.	3 shares.	
Kuljas Rai	2 ,,	10 shares.

For 31-32, there was a default assessment. For 32-33 there was first a version that the business had been succeeded to by another B. C. G. A. subsidiary, styled "Produce Trading Company, Okara", but eventually it was held that that concern was not a successor, and assessment was made up to the closing of this concern 12-4-31. A loss was accounted, but by disallowance of certain unproved bad debt claims, a profit assessment was made.

Neither the profit nor loss is traceable in the Company's accounts in record. Its present Balance Sheets treat its investments with those "Produce Companies" as "Current accounts" just the same as the "Seeds Department." The implication is that there were two Seeds Department partnerships, and that the present "Current Account" is an amalgamation of the investments in both.

The assessee seeks offset of 1,78,052, amounting to practically the whole difference 1933-34. It is made up of 38 debit balances listed at page 37 of the record; against dates which appear to be those of last account entry or of pronote etc. The greater part fall against dates in the year ending September 1931; but *not* quite all. Those which do not are of small comparative total: and the principal items are all of that year including items of 65,000, 36,000, 32,573, and 21,000.

The amount not yet written off is said to be wholly comprised of amounts reaching limitation in the subsequent year.

11. The assessment order disallowed claim on the footing:

(*a*) "The debts were definitely considered to be bad in the Company's balance sheet ending 30-9-33." The present claim was only now on the score of limitation, which was not conclusive of date of due offset.

(*b*) The loss arose from a discontinued partnership, and was not allowable in any event, on the authority of *South Indian Industrials, Ltd.*

12. The grounds of appeal merely asserted the claim without any specific reply to these findings. No further evidence or material was proffered or propounded; and indeed as noted in the final para of the appellate order, despite the Assistant Commissioner's specific offer to take evidence of the actual date of realised badness, the assessee declined to give any, and obstinately took his stand soley on the limitation issue.

13. The petition gives a further description of the business done. It accepts the version that there was a separate partnership. It is said to have been started in 1930, and to be wholly financed by the assessee. The business is said to have been forward-dealings for constituents (including the assessee himself). The losses were incurred for the constituents, in excess of their margin deposits. The business was stopped in 31-32 account. The balance-sheet figure is described as the amount "invested in financing the business." (It is not explained how it tallies with the debts due to the partnership by the defaulting constituents).

The petition includes no argument whatever as to the issue of accountability. One of the propounded questions is in general terms, but the detail questions advert only to the date issue.

14. The petition seeks to allege in support of the limitation criterion a prior acceptance of that basis: doubtless for the purpose of argument on one of the case-decisions which will be mentioned below.

As already noted, there was no bad-debt items of any kind prior to 1933 account. That account showed the small loss of 16,000 odd (para 3). The assessee included in this loss two dozen items of bad debts from zemindari (Estate) tenants, totalling 6677: without any date particulars in claim (page 6).

The assessment was unfortunately handled by a slack and incompetent officer. (A note appended by him to his order would of itself be a reflection on his competence). He paid not the slightest regard to my comments in the 32-33 case, and did not even get the Balance Sheet, whose importance I had pointed out; (and it is apparent, if anything more is needed to show it, from the present case). His Inspector'sreport includes the more or less unintelligible sentence: "To produce old ledgers. Old ledgers have been produced and examined. A list of bad debts has been placed on file. Bad debts are properly written off and may be allowed." There is not a line of addition by the Income-tax Officer to that record; and his order is only a sketchy summary of the Inspector's report. including "Bad debts are properly written off and have been checked and I allow."

As already mentioned, some of the items in the Seeds Department books also reached limitation in that year, and were not then claimed.

That is the whole recorded material bearing on the contention in the petition that limitation has been accepted by the Department as an automatic criterion of badness in this particular case. The version of any such past acceptance was not put before the proper officer (the Assistant Commissioner) at all, and accordingly is not dealt with at all in the appeal order out of which the questions of law lying in the competence of Your Lordships must arise.

Opinion.—15. I have already explained the necessity of a proper finding as to actual date of eventuation of realised irrecoverability, for the proper determination of the charge imposed by the Act.

Now the Privy Council in the cases of *Sir S.M. Chitnavis* and *F. E. Dinshaw* have emphatically laid down that the "point of time at which the debt becomes a bad debt is a question of fact to be decided in the event of dispute by the appropriate tribunal. Limitation will not of itself make the debt a bad debt. A statute barred debt is not necessarily bad; neither is a debt which is not barred necessarily good." Further the onus upon the assessee to establish his version by evidence is affirmed in the case of *Sir S.M.*

Chitnavis as well as in less authoritative judgments, such as *Binjraj Hukam Chand In re* and *B. K. Haldar In re.*

It would seem that Counsel may have neglected to draw Your Lordships' attention to this Privy Council authority, in the cases of *Hukam Chand* (24-1-36) and *Harnand Rai Harbhagat Rai* already cited in para 4. Your Lordships considered that that assessee "would have been guilty of a fraud if he had claimed badness before the expiry of limitation," even though the statement of case found in fact that all reasonable hope of recovery had been lost before that year. (It was added of course in *Hukam Chand In re* that it was open to find in fact that despite limitation debt was even then not yet "bad": but obviously that could not arise after the facts stated).

The question of limitation bar was examined in more detail in *Banishidhar Poddar In re.* The Court agreed that limitation was not conclusive either way, and that badness was an issue of fact: but observed, "It has been the practice of the Income-tax Officer, and one cannot say that it is an unreasonable practice, to regard a debt as bad *prima facie* when it is barred by limitation ....There being no other finding of fact before us to show when the debt became bad, other than the finding of fact that it became bad by reason of the fact that it was barred, the assessee is entitled to the deduction." I think this should be read in the light of the special circumstances of that case, and the Commissioner's volte-face in course of the proceedings. The disallowance was initially solely on the ground that limitation fell in an earlier period. On mandamus, the Commissioner had to accept that limitation fell in this period; but (may I say, unhappily) sought still to negative the claim on the ground the assessee had not given evidence of badness other than limitation.

16. It is obviously because of those rulings that Mr. Kirpa Ram has sought to introduce at this improper stage the matter discussed in para 14 above, although it was not referred to at all by the assessee and his original counsel before the proper tribunal.

The whole history of the case leaves me in some doubt whether the protraction of the claim was altogether deliberate whether the assessee, well knowing that these amounts were bad, but having losses already just enough to get as much carry forward as the Act allowed, decided to try to hold the claim over until an anticipated or hoped for profit account. However that be, I am at least sure that the present position he is taking up amounts to the same thing. He is insisting on the limitation criterion because in the

event it does enable him very conveniently just to cover the real profit, (allowing for rejection of the claim under fourth issue which he obviously does not expect to have accepted) and also leaves him with another 2¼ lakhs to carry forward. (It should be noted that it is substantially a controlled company. About 62% of the capital is owned by the Manchester company: 14% by a subsidiary: and 22% by the managing director).

I am satisfied that there is no prior history of specific acceptance of limitation as a *prima facie* criterion in this particular case. On the other hand the Auditors' entries referred to in the assessment order were *prima facie* material for ascribing the irrecoverability of these debts to an earlier year. The assessee when put to proof under Section 23 (2) of the Act, absolutely declined to furnish any evidence at all.

17. But I am not sure that it is these debts due to the partnership that lie in consideration at all. The assessee's account was with the partnership; and the effective position is that as a partner he had rights against those debts which he was seeking to exercise. I to dot think a partner can have a bad debt against his own partnership, in view of the several liability of partners. (It is not a matter of the kind coming into *Rm. Ar. Ar. Rm. Arunachalam Chettiar & Son* and the Privy Council appeal therefrom, dated 27-2-36. That was an issue as to liability of the other partner. Here the other partners are said in the petition not to have any liability. There is no evidence on that point, but I do not think it enters into relevance).

This is another aspect of the line adopted by the Assistant Commissioner, that it was a loss in a "discontinued business" in other words, a loss that had been capitalised. His ground is supported by *South Indian Industrials Ltd.* (in contrast with *Sidha Gowder & Sons*). I may also refer to the Privy Council case in *P.R.A.L. Muthukaruppan Chettiar* dealing with another aspect of a dissolved partnership. It was held that sums actually received at dissolution did not lose their character of profits. This is not inconsistent with the view that the capital reduced by losses is capital.

I have already noted that the petition contains no reply, and no detailed question in this regard; and I do not know whether the assessee contests it at all, or on what grounds he contests it. I think it was a capital loss. There is no suggestion, and certainly no evidence, that the business was being continued by the

assessee as sole successor to the partnership. Indeed his own petition uses the words, " owing to these adverse circumstances, the partnership business *had to be closed* during 31-32 ". Moreover the amounts were real " losses " : they were not sums ascribed to received account in advance of realisation, and subsequently not recoverable, but were deficits on transactions for constituents, with recourse to them which failed and so not " bad debts " as such. From every possible aspect, the deficit lies in capital account.

18. Question of "capital and revenue" are (as in 14 T.C.403 etc.) primarily issues of fact: and I find the questions properly arising to be :—

Second Question :—The assessee having been the sole financing partner in a business which had been discontinued, leaving sums due to the partnership from third parties in respect of their liabilities on contracts made on their behalf, was it impossible in law to find that the deficit in the account of the assessee with the partnership was not established by the assessee-claimant to lie in revenue charge.

Third Question :—The assessee having claimed, as his deficit in the above account, the amount of sums due to the partnership which reached limitation in and before the year of account; and having failed to produce evidence to the Assistant Commissioner (who had material for ascribing their badness to an earlier year) either that the amounts reached *de facto* irrecoverability in the year of account, or that there had been any regular practice of *prima facie* ascription of badness to the limitation year: *query* was it impossible in law for the Assistant Commissioner to find that the said amount was not proved to be a deficit in account with the partnership, reaching irrecoverability in the said year ?

In the Commissioner's opinion the evidence did not establish that the deficit in issue would be in revenue account when it eventuated : and did not establish that the deficit eventuated in the year of account.

Third Issue :—19. The Balance Sheet record of loans to tenants runs :—

	Sept. 1932	1933	1934.
Consider good	63,418	59,996	56,792
Consider bad and doubtful	18,523	18,311	22,809

The write-off of 6,677 in previous account has been described in para 14 above. In the present (1934) account, there was filed a list of 49 accounts, some at debit and some at credit; and the 35 debit items were shown as bad debts written off, 13,884. A

subsidiary list was also put in of 891, making up the claim now in issue, Rs. 14,775.

The assessment order assumes, and it is not denied, that these were all from the 1933 "bad and doubtful" category.

Again no date-particulars appear in record; but the assessment order takes it that all the amounts did reach limitation in the period. No other particulars were put before the Assistant Commissioner. He indeed raised doubt whether the deficits were all in Money-lending account at all, but in view of his rejection of claim on the matter of date did not resolve it. (Sometimes assessees of this class transfer unrealised agricultural rents to Loan-account; and this presumably is what the Assistant Commissioner had in mind).

21. Thus the only question arising from the appeal order is this matter of date; (though if Your Lordships' order put the matter back into issue, the question of revenue admissibility will have to be dealt with).

As above, there is no evidence of acceptance of a limitation criterion in the prior year. But whatever was then the basis for date, I personally should be prepared to adopt limitation as a *prima facie* criterion for a comparatively petty account *of this running nature.* I do not think however that any useful purpose would be served by intervention under Section 33 at this stage; and as the question has some bearing on the major item, I shall state the issue as it stands, and defer any Section 33 consideration until after judgment.

In pure issue of law, the case is perhaps not quite as conclusive in regard to this item as for the major item, if what happened as described in para 14 lies within Your Lordships' consideration. (I do not think it does so lie). Even so, I think the auditors' description of these items in 1933 as then "bad and doubtful" was sufficient primary reason for requiring proof that badness had not in fact eventuated in that period; and as above (doubtless influenced by not wishing to weaken the absolute claim for the limitation criterion in the major item) the assessee refused to furnish any evidence. Hence in issue of law this detail stands likewise as one of absolute claim for deferring every bad debt to the limitation year, despite the express decision of the Privy Council that this is not sustainable.

21. I find the question properly arising to be :—

Fourth Question.

The Assistant Commissioner having reason to believe that

debts in business account totalling Rs. 14,775 reached *de facto* irrecoverability in a prior account, and the assessee having declined to give any evidence of date of this *de facto* irrecoverability, was the Assistant Commissioner bound in law to allow claim on the groundof limitation reached in the account period?

In the Commissioner's opinion, he was not so bound.

Fourth Issue.

Mr. Dart was a Bombay cotton-speculator (trading as Dart and Co.) who got into financial difficulties and committed suicide in 1930. The official Assignee took charge of the deceased's estate. Certain payments were made, apparently mostly in 1931-32. On enquiry in October 1934 the Official Assignee wrote, " I cannot say definitely when and what dividend will be declared. Declaration of dividend depends on realisation of decrees. There would probably be a dividend of 2 to 3 pies in about March 1935."

The assessment order states that in fact a dividend was received in November 1935.

23. The original account with the deceased is not in record. It appears that cotton had been consigned to him for sale, and remained unsold, and was (the petition says) got hold of and sold by the assessee leaving an amount due. It is not clear what the deceased's liability would be in such circumstances; but I need not get evidence of the nature of the claim, since it is apparent that a gross claim of 90,069 was admitted. Of this, part related to a subsidiary. The assessment order says that the assessee company accepted liability to the subsidiary; and indeed the amount which Mr. Kirpa Ram has himself set out in his petition is the whole deficit (74,872), after payments against the gross sum above. But the claim in assessment and appeal is only for the appropriate share (40,813), the other part being attributed to the subsidiary without recourse. The Balance Sheet figures are :—

September 1932	1933	1934
77,217	75,810	...

and these imply that the Income tax Officer's version was correct; but that what the assessee was doing was to split up his claim so as to get a reduction in the subsidiary's case, since he expected his assessment in the event to make that balance share useless to him in his own case.

24. Those matters however do not affect the actual issue raised, which is only as to date.

The assessment order does (as the petition says) read ambiguously; but allowing for defects of draftsmanship amounts to this;

that the amount was "bad" long before, except in so far as dividends were obtainable: and these were certainly not ended within the account period.

The Assistant Commissioner also tied himself up with reference to the previous discussion of items classed "Bad" at an earlier stage by the auditors. (Actually neither of the Balance Sheets, as appearing in record, does label this item bad at all). His order similarly amounts to this, that whatever "badness" there was, was the same in this year as in the earlier years referred to: and on the other hand the dividends had not ceased. I imagine the drafting took this form probably because of some argument that the comparatively small amount of expected balance dividend should justify writing off without awaiting the winding up of the insolvency.

Of course, no question of limitation comes into this item.

25. As in *F. E. Dinshaw's* case the scheme of the Act does not allow for piecemeal write-off. The loss eventuates when the whole balance of any item reaches irrecoverability. On this footing the amount in issue certainly did not fall bad until after the period.

And as argued by the Assistant Commissioner, if this were not the criterion, then the badness would certainly have matured earlier than this year.

On no footing, whether strict or concessionary, could this deficit possibly be attributable to the present year.

26. I find the question properly arising to be :—

Fifth Question.

The assessee having an amount due from an insolvent estate, as to the badness of which the only evidence was that petty realisations were received during the prior year and the subsequent year, was it impossible in law for the Assistant Commissioner to find that badness thereof did not eventuate in the year of account?

In the Commissioner's opinion, the Assistant Commissioner's finding was not only maintainable, it was incontestibly correct.

Accordingly the five questions contained in paras 9, 18, 21, and 26 are referred for Your Lordships' judgment.

The tax in issue (after bringing into consideration the Depreciation balances) is approximately Rs. 35,300. Although all the contentions are *prima facie* in the category of fact, they involve principles of accounting practice of general applicability and great importance. In these circumstances, if Your Lordships please, it is requested that the case may be decided in Full Bench."

Kirpa Ram Bajaj, for the petitioner.

S. M. Sikri and *J. N. Aggarwal*, for the Commissioner.

JUDGMENT.

DIN MOHAMMAD, J.—This is a reference under section 66 (2) of the Indian Income Tax Act. The five questions of law propounded by the Commissioner have arisen out of the appellate order of the Assistant Commissioner in the matter of the assessment of theBritish Cotton Growers' Association (Punjab) Limited. (hereinafter called the assessee) for the year 1935-1936.

The assessee while computing his total income claimed the exclusion of certain items, but this was disallowed by the Income Tax Officer. On appeal the Assistant Commissioner affirmed the conclusions arrived at by the Income Tax Officer regarding these items. Thereupon the assessee petitioned the Commissioner challenging the decision of the Assistant Commissioner on the points covered by these questions. Hence this reference. The first question formulated by the Commissioner is:—

"Has the assessee established justification for excluding the sum of Rs. 12,447 charged against Wazir Chand-Chaman Lal, from interest account (and crediting it to Suspense), out of ordinary course; by evidence so cogent that in issue of law it was impossible for the Assistant Commissioner to hold such justification not proved?"

This question has arisen in the following circumstances. A cotton ginning and pressing factory belonging to the firm Wazir Chand-Chaman Lal was in 1930 mortgaged to the assessee for Rs. 1,50,000. Sometime later it transpired that the mortgagors were not in a position to discharge the mortgage debt. Consequently, the assessee entered into an agreement with the mortgagors by which it undertook to finance the working of the factory and to appropriate the profits to their loan account. In the year of accounting, the assessee made a profit of Rs. 90,000 and after appropriating this sum to the entire amount outstanding against the mortgagors, debited them with a sum of Rs. 68,365 which represented the balance due from them. This sum included an amount of Rs. 12,447 on account of interest which was, however, after being entered in the mortgagor's account, taken to Suspense account, and was thus excluded from the computation of profits. At the assessment a question arose as to whether this amount could be so excluded. The assessee contended that it had been properly excluded while the department held otherwise. The

question now before us, in plain language, is whether this exclusion can be upheld.

Counsel for the assessee has, at the outset, urged that the question has not been properly framed, and that the onus of proving that the amount in question could not be excluded or, in other words, was taxable, should have been placed on the Income Tax authorities and not on the assessee. In my view, the true legal position is this. By Sec. 13 of the Income Tax Act, income, profits or gains are to be computed for the purpose of Sec. 10, with which alone we are at present concerned, in accordance with the method of accounting regularly employed by the assessee and it is common ground that assessee has been regularly following what is known as the mercantile system. Under that system entries are made in the accounts on the date not of receipt or expenditure of money but on the date of transaction irrespective of the date of payment. Ordinarily, therefore, as soon as the transaction in question was entered, the assessee could be said to have received the sum of Rs. 12,447 by way of interest, whether it was actually realized or not. In fact, the assessee admitted before the Assistant Commissioner that no other similar item had been credited to the Suspense account and further that the opening of this 'Suspense account' was not in accordance with its general system of accounts. Interest debited to the debtor's personal accounts had in every other case been credited to the interest account and the only reason advanced for this variation was that the assessee was not hopeful of recovering it. It was on this account that the Income Tax authorities came to the conclusion that this item should have been included in the accounts of income and that its exclusion was 'out of ordinary course' and 'for reasons not to be justified'. In these circumstances, whatever the form of the question, in my view, in the words of their Lordships of the Privy Council in *Foroz Shah* v. *Income Tax Commissioner, Punjab*, the only question open to judicial determination is whether there was any evidence before those officers upon which they might find that the appellant's system of accounting required the inclusion in his accounts of this item.

Now, the assessee justifies the exclusion of this item before us on the grounds, first, that it was a part of its regular system of accountancy to exclude such items inasmuch as it had similarly excluded an item in the preceding year without any protest on behalf of the Income Tax authorities, and second, that in spite of the mercantile system, this item was liable to exclusion, as it was

not under its control in such a way as to be convertible into cash at any time that the assessee liked. In support of the first ground the assessee relies on its balance sheet for the year ending 30th September 1933. It is true that in that balance sheet, a sum of Rs. 18,000 odd was credited to the Suspense account and it was left unchallenged by the Income Tax authorities; but that solitary instance is not, in my opinion enough to establish that the exclusion of that item was based on any system adopted by the assessee or that that system was regular. An assessee is, no doubt, at liberty to adopt any system of account that he likes, but as indicated in Para. 50 (1) of the Notes and Instructions regarding the Income Tax Law and Rules, it must be one that clearly reflects his income in respect of the fixed period of the 'previous year' and that it is the one regularly adopted by him for the purposes of his business. In this case, the assessee's own admission that this crediting to the Suspense account is not based on any regular system clinches the whole matter. The first ground urged by the assessee, therefore, fails.

Coming now to the second ground, the assessee has relied on *Secretary to the Board of Revenue, Income Tax, Madras* v. *Arunachalam Chettiar* (particularly the remarks made by SADASIVA AYYAR J.), *Pandurang Ramachandra* v. *Commissioner of Income Tax*, *Commissioner of Income Tax* v. *Nanhelal* and *Jagmandar Das Vaish* v. *Commissioner of Income Tax, Central and United Provinces*. In *Secretary to the Board of Revenue, Income Tax, Madras* v. *Arunachalam Chettiar*, it was held by the majority of the Court that interest which accrued due to a money lending firm in the year of account was not assessable as a profit of the business unless it was received or realized in that year. In the course of his judgment SADASIVA AYYAR, J., expressed an opinion that an income to be assessed must accrue or arise in the sense that it should be so completely under the assessee's control that in the language of LORD FITZGERALD "by an act of his will he would have it actually transferred to its bankers." This judgment, however, has lost its force as the Act was amended afterwards apparently to nullify its effect and is, therefore, no longer good law. See *Sundaram's Law of Income Tax in India*, page 458.

In *Pandurang Ramachandra* v. *Commissioner of Income Tax*, the assessee contended that he was not liable to be assessed on prospective interest, not actually realized by him or payable during the assessment period and on this ground a mandamus was issued to the Commissioner to state the case. All that was decided

in this case was that the question whether such interest was taxable or not was a question of law.

In *Commissioner of Income Tax* v. *Nanhelal* the method of accounting was mercantile but it was held that sums shown in the accounts as having fallen due but not received or paid in cash or by adjustment of accounts could not be treated as assessable income.

In *Jagmandar Das Vaish* v. *Commissioner of Income Tax, Central and United Provinces*, a Division Bench of the Allahabad High Court, mainly relying on the three judgments mentioned above held that an unrealized decree, although shown in the account books, was not taxable.

These judgments, however, in my view are not applicable in the present case, as, in all of them, the assessee does not appear to have shown the interest accrued as interest received while in the present case it is not denied that any sum entered in the interest account although not actually received in cash or realized is all the same received under the system of account adopted by the assessee. The only ground for exclusion relied upon by the assessee is that there was no hope of its recovery and apart from the fact that that is a different matter, there was not a shred of evidence before the Assistant Commissioner to substantiate that plea.

On behalf of the Commissioner reliance has been placed on *Commissioner of Income Tax, Madras* v. *Subramanian Chettiar*, *V. S. A. R. Firm* v. *Commissioner of Income Tax*, *J. Kesava Rao* v. *Commissioner of Income Tax*, and *Feroz Shah* v. *Commissioner of Income Tax.* In *Commissioner of Income Tax, Madras* v. *Subramanian Chettiar*, a Full Bench of the Madras High Court held that the assessee having adopted the mercantile system of accountancy must be assessed upon that basis alone, and so assessed, the amount of interest entered in the accounts as a profit and as money actually received like other interest entries, was income accruing or arising within the meaning of Section 4 (1) read with Sections 10 and 13 of the Income Tax Act.

In *V. S. A. R. Firm* v. *Commissioner of Income Tax,* in a case where the assessees treated as realized in the interest account as well as in the debtor's accounts the interest included in fresh promissory notes or mortgages taken in a settlement of account to cover outstanding principal and interest and were assessed to income tax on the interest so included in the previous year, a Full Bench of the Rangoon High Court held that there was

material to justify the finding that the said sum was interest on loans that had accrued to the assessee during the accounting year and as such assessable to income tax. In that case, all the relevant judgments of their Lordships of the Privy Council were duly considered and explained.

Similarly, in *J. Kesava Rao v. Commr. of Income Tax*, a Full Bench of the Madras High Court held that where in accordance with the method of accounting regularly followed by the assessee in his money-lending business year after year, interest included in renewed promissory notes and mortgages was debited to the debtors' accounts and credited to the interest or profit account at the time of renewal interest so included could be considered as income realized for purposes of assessment to income tax.

In *Feroz Shah v. Income Tax Commissioner* their Lordships of the Privy Council recognised that the outstanding feature of the mercantile system of account was that transactions were recorded on the dates when they were effected, whether cash payment was then made or not.

The two judgments reported in 8 I.T.C. are distinguishable inasmuch as the account had been adjusted in those cases, but the other two judgments relied upon by the Commissioner do bear out his contention.

In view of the above discussion, I would hold that there was evidence before the Assistant Commissioner to justify the course adopted by him and that the assessee had not placed any material on the record which would have warranted the exclusion of the item in dispute from its total income.

Questions Nos. 2 and 3 relate to one and the same matter and may be set out together. They have been formulated as follows :-

Question 2: "The assessee having been the sole financing partner in a business which had been discontinued, leaving sums due to the partnership from third parties in respect of their liabilities on contracts made on their behalf was it impossible in law to find that the deficit in the account of the assessee with the partnership was not established by the assessee-claimant to lie in revenue charge ? "

Question 3: "The assessee having claimed as his deficit in the above account, the amount of sums due to the partnership which reached limitation in and before the year of account ; and having failed to produce evidence to the Assistant Commissioner (who had material for ascribing their badness to an earlier year), either that the amounts reached *de facto* irrecoverability in the

year of account, or that there had been any regular practice of *prima facie* ascription of badness to the limitation year ; *query*, was it impossible in law for the Assistant Commissioner to find that the said amount was not proved to be a deficit in account with the-partnerships reaching irrecoverability in the said year."

The material facts are these. In 1928, the assessee started a separate business under the style of the "Seeds Department" at Khanewal, Okara, Mian Channu and Vihari. At Mian Channu and Vihari the business was conducted through paid employees while a partner each was taken at Khanewal and Okara. These partners were allowed a definite share in the profts of the venture but were saddled with no liability for its losses. The business was however, to be financed by the assessee alone. The account books were maintained at Khanewal and contained separate ledger account for each branch. The assessee suffered heavy losses in this business and had to close it in 1931. For some of the moneys outstanding against the debtors, bonds were accepted which, however, could not be realized and which eventually became time-barred in the account year. These bonds were of the value of Rs. 1,78,052. In the present assessment the assessee claimed to exclude these bond debts as irrecoverable loan and both the Income Tax Officer and the Assistant Commissioner disallowed the claim on the following grounds :—

(a) That the claim related to a business which was discontinued in 1931 and was thus inadmissible under Section 10 of the Income Tax Act, which was confined to a current business alone.

(b) That the claim related to distinct firms since discontinued.

(c) That there was no evidence that the loans became irrecoverable during the account year inasmuch as the mere fact that limitation had expired during the account year was not enough to prove their irrecoverability during that year.

The Commissioner in his statement of the case has endorsed these views and has further remarked that in his opinion the amount claimed was not a revenue loss but a " capital loss ".

The assessee contends at the outset that even on facts found, the Income Tax authorities were not justified in holding that there was any partnership in existence and that the so-called admission attributed to it was not conclusive inasmuch as it had used the word 'partnership' loosely in order to denote the nature of its relationship with the two outsiders at Khanewal and Okara respec-

tively. In support of its contention that the relationship in question did not constitute partnership in the eye of law, the assessee has relied on *Commissioner of Income Tax* v. *Mahomed Kassim Rowthar*. There, several persons had executed an agreement in favour of the assessee by which each of the executants was to have a certain share in the profits of the business when ascertained. No provision was made for their liability in case of loss and the complete control of the business was retained by the assessee who had contributed the whole capital. Not only was the assessee to have the control of the business but even persons holding power-of-attorney from him were to exercise the same power. Further the executants had agreed to be bound by his orders and the orders of his attorneys, and had also agreed that if they contravened the provisions of the agreement, they could be dismissed. The assessee as proprietor had also the power of altering their shares. It was in these circumstances that the learned Judges of the Madras High Court held that there was no 'valid and genuine' partnership. That judgment is obviously of no relevancy in the present case, as the facts on which it proceeds are entirely different from the facts before us.

The mere circumstance that a person is to share profits only and not losses does not by itself militate against the presumption of partnership. Under section 4 of the Indian Partnership Act, 1932, 'partnership' is defined as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all." In English Law, where the Act merely says that the receipt by a person of a share in the profits of a business is *prima facie* evidence that he is a partner in the business, it has been held that the inference that where there is community of profit there is partnership is so strong that even if community of loss be expressly stipulated against, partnership may nevertheless subsist." (See *Lindley on partnership*, 1935 edition, page 47). The same learned author at page 41 observes: "The effect of sharing profits as *prima facie* evidence of partnership was considered by the Court of Appeal in the case of *Badaley* v. *Consolidated Bank* and was there explained to be that if all that is known is that two persons are participating in the profits of a business, this, unless explained, leads to the conclusion that the business is the joint business of the two, and that they are partners." I am of opinion, therefore, that the business in the name of the 'Seeds Department' was to all intents and purposes a partnership business. In fact from the various orders of

the Income Tax authorities it appears that throughout the proceedings before them, the assessee had maintained that position and the only plea raised was that the amount represented 'valid bad debts'.

This being so, the question arises whether the assessee can claim any relief on account of those losses, the business having been long discontinued before the year of account. The answer is clearly in the negative. In *South Indian Industrials Ltd.* v. *Commissioner of Income Tax, Madras*, in a case where the assessee had carried on several separate businesses before, but in the account year some of those businesses had closed, a Special Bench of the Madras High Court held that the assessee could not set off the losses of the discontinued businesses against the profits of the current businesses, inasmuch as Section 10 of the Income Tax Act dealt with businesses that were being carried on and not with businesses which had ceased to exist, and further that the losses were capital losses and not revenue losses. It is indisputable that where a person carries on two different trades, he is entitled to set off for purposes of income tax the loss incurred by him in respect of one against the profit made by him in the other. This principle was recognized by their Lordships of the Privy Council in *Arunachalam Chettiar* v. *Commr. of Income Tax, Madras*, and has been followed in several courts in India, (see among others, *Commr. of Income Tax, Madras* v. *Arunachalam Chettiar*) but for this principle to apply the condition precedent is that both businesses should be alive during the current year. A dead business's loss cannot be set off against a living business's gains. I would, therefore, answer question No. 2 in the negative.

In view of my finding on Question No. 2 as was conceded by the assessee in the course of arguments, Question No. 3 does not arise.

I now come to Question No. 4. It reads as follows:—

The Assistant Commissioner having reason to believe that debts in business account totalling Rs. 14,775 reached *de facto* irrecoverability in a prior account, and the assessee having declined to give any evidence of date of this *de facto* irrrcoverability, was the Assistant Commissioner bound in law to allow claim on the ground of limitation reached in the account period."

The facts bearing on this question are simple. The assessee as a money-lender advanced certain loans to its tenants, which became time-barred in the year of account. These items were consequently claimed as bad debts but the claim was disallowed

both by the Income Tax Officer and the Assistant Commissioner. Both officers mainly relied on the balance sheet of the assessee for the year ending 30th September 1933 and remarked that the assessee having itself considered these debts as bad in that balance sheet could not urge that they had become bad during the account year merely because their limitation had expired in that period. The Commissioner while agreeing with this view has left the question of their admissibility open even if it were held that the debts had become bad during the 'previous year.' Counsel for the Commissioner has drawn our attention to *Commissioner of Income tax, C. P. & Berar* v. *S. M. Chitnavis* and *F. E. Dinshaw* v. *Commr. of Income tax, Bombay*, and has urged that it is not open to us to go behind the finding arrived at by the appropriate tribunal as to when the debts had become bad. In *Commr. of Income tax, C. P. & Berar* v. *S. M. Chitnavis* their Lordships of the Privy Council observed: "Whether a debt is a bad debt, and if so, at what point of time it became a bad debt, are questions which in their Lordships' view are questions of fact, to be decided in the event of dispute by the appropriate tribunal, and not by the *ipse dixit* of any one else. The mere fact that a debt was incurred at a date beyond the period of limitation will not of itself make the debt a bad debt; still less will it fix the date at which it became a bad debt. A statute-barred debt is not necessarily bad; neither is a debt which is not statute-barred necessarily good. The age of the debt is no doubt a relevant matter to take into consideration. In every case it is a question of fact to be determined after consideration of all relevant circumstances." The same principle was reaffirmed in *F. E. Dinshaw* v. *Commr. of Income tax, Bombay*. There the debts were due from a going concern and in the judgment under appeal it had been remarked that to constitute moneys due by a company a bad debt or a business loss to the creditor, it is necessary that the company should have ceased to be a going concern. Animadverting on these remarks, their Lordships remarked:

"Their Lordships know of no principle or authority upon which these views of the learned Chief Justice can be supported. Whether a debt is wholly or partly and to what extent bad or irrecoverable is in every case (and whether the debtor is a human being or a Joint Stock Company or other entity) a question of fact to be decided by the appropriate tribunal upon a consideration of the relevant facts of that case. There is no justification for the suggestion that a practice should prevail in the Commis-

sioner's office under which a debt due from a limited Company which is still a going concern is incapable of being treated as a bad debt."

In view of such clear pronouncements of their Lordships of the Privy Council, I consider that the only thing open to us in this matter is to determine whether the finding arrived at by the appropriate tribunal is vitiated on any ground or, in other words, is perverse or unwarranted by the material on the record. If once it is found that the finding is based on relevant and admissible evidence, our interference will be barred.

As stated above, the finding of the Assistant Commissioner that these debts had become bad during the preceding year is based on the balance sheet for the year ending September 1933 where these debts were shown under the head 'Bad and Doubtful.' It is further remarked by the Assistant Commissioner that the assessee has adduced no evidence to show that the debts had become bad during the year of account and that it has solely relied on the limitation test which is not final. In these circumstances, it cannot be said that this finding is bad in law. It may be an erroneous finding of fact but nevertheless it is conclusive. It has been remarked by their Lordships of the Privy Council in the case of second appeals, that however gross the error, High Courts have no jurisdiction to entertain a second appeal on the ground of an erroneous finding of fact: *Durga Chowdhrani* v. *Jowahir Singh* and *Rajah of Pittapur* v. *Secretary of State.* The same principle applies here. I would, accordingly, answer Question No. 4 in the negative.

Question No. 5 is as follows:—

"The assessee having an amount due from an insolvent estate, as to the badness of which the only evidence was that petty realisations were received during the prior year and the subsequent year, was it impossible in law for the Assistant Commissioner to find that badness thereof did not eventuate in the year of account?"

This question relates to a transaction which the assessee had with a trading concern known as Dart and Company. It is common ground that the Official Assignee in whom Mr. Dart's estate vests at present has not wound up the whole affair and has even after the year of account paid paltry dividends to the creditors of the estate. The Income Tax Officer, however, came to the conclusion that the debt had in fact become bad long before the commencement of the previous year and consequently disallowed the

item. The Assistant Commissioner agreed with the Income Tax Officer but on grounds which were not correctly expressed. In fact, his reference to the previous balance sheets was erroneous. The Commissioner pointed out the mistake but supported the final conclusion on the ground that the scheme of the Act did not favour 'piecemeal write-off.' He observed "The loss eventuates when the whole balance of any item reaches irrecoverability. On this footing the amount in issue certainly did not fall bad until after the period." The assessee contends that the mere expectation of a negligible dividend does not keep the debt alive but, in my view, in maintaining this position, the assessee lays itself open to the criticism advanced by the Income Tax Officer and the Assistant Commissioner, and invites the finding that the debt may have become bad prior to the year of account. As I read the Commissioner's order, however, that finding has been set aside and has now been replaced by a finding that the debt had not become bad even during the year of account. To my mind, this position in the circumstances of the case is most reasonable. So long as there is any ray of hope left to recover a debt, however dim it may be, and so long as a debt is in the process of realization, it cannot be said that it has become irrecoverable. I would, therefore, support the Commissioner's view in this matter in preference to the finding of the Assistant Commissioner and answer Question No. 5 in the affirmative.

MONROE, J.— I agree.

BHIDE, J.—I agree.

Questions answered accordingly.

[IN THE LAHORE HIGH COURT.]

AMRITSAR PRODUCE EXCHANGE LTD., *In re.*

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

February 8, 1937.

GOVERNMENT SECURITIES—QUASI BANKING BUSINESS—INVESTMENT OF DEPOSITS RECEIVED FROM CUSTOMERS IN SECURITIES—PROFITS MADE BY SALE OF SECURITIES, WHETHER ACCRETION TO CAPITAL OR REVENUE—WHETHER CASUAL AND NON-RECURRING RECEIPT—ASSESSABILITY—BURDEN OF PROOF OF EXEMPTION—

PURCHASE OF DEBTOR'S PROPERTY—PROFITS MADE ON RESALE, WHETHER CAPITAL OR INCOME—INTENTION OF PURCHASER—ACCOUNTS KEPT ON MERCANTILE BASIS—ASSESSMENT ON CASH BASIS FOR SUBSEQUENT YEAR—ASSESSEE'S RIGHT TO RELIEF FOR OVER-ASSESSMENT—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 13, 4 (3) (VII), 48-A (1).

It cannot be laid down as a general rule that in every case an investment in the shape of securities made by a concern should be fixed capital. On the other hand, in every case it is to be determined on its own facts whether the investment was a part of the ordinary business of the investor or otherwise.

If it could be found that an investment had been made for the purpose of permanently excluding a certain sum from the floating capital of a concern, it might be permissible to hold that that sum was intended to serve as a reserve or, in other words, as fixed capital having no concern with the stock-in-trade. If, on the other hand, the facts relating to the investment unequivocally point to the conclusion that the investment is to all intents and purposes a part of the business and that the sum so invested is intended to serve as stock-in-trade, the profits arising therefrom will form part of the income of the concern.

It is the intention of the assessee that is to be considered in such matters and when once it is found by the Department as a matter of fact that the assessee's intention was to make profits from these investments as a part of the assessee's business it is doubtful whether the High Court can go behind that finding.

If exemption is claimed under Sec. 4 (3) (vii) of the Income Tax Act by an assessee, the burden is on him to show that it did not arise from business and is of a casual and non-recurring nature.

The assessee carried on business as a Produce Exchange, a business of a quasi-banking nature, and received large amounts of deposits from its clients in the course of its business. The deposits were invested in Government Securities and in the accounting year the securities were sold at a profit. Held : (*i*) *that the profit thus earned was not of a capital nature but was income* ; (*ii*) *that it was not a receipt of a casual or non-recurring nature not arising from business within Sec. 4 (3) (vii) of the Act and was therefore liable to be assessed to income tax.*

Dictum : *English judgments can be utilised as aids in the interpretation analogous provisions of law, though not as binding*

authorities on those matters where the language of the English and Indian Acts differ.

When a creditor takes over the property of his debtor in discharge of the loan and makes a profit by selling the property the question whether this profit is an accretion to capital or revenue depends on the intention of the creditor at the time of purchasing the property; if the object of the purchase was to resell at a profit as soon as a suitable opportunity arose, the profit would come into the revenue account and would be assessable to income tax.

The assessee was in the habit of compiling his accounts on the mercantile basis and even with regard to interest on securities it was brought into the profit and loss account though it had not been received. In the year in question the Income Tax Officer adopted the cash basis and assessed the amount actually received by way of interest. The assessee claimed that the current assessment should be reduced by the over-assessment: Held, *that the question whether the procedure adopted by the Income Tax Officer was illegal depended on the true construction of Sec. 48-A (1) and (2); that that section comes into play only when income tax had actually been paid in excess and not earlier, and there was no provision of law under which relief could be granted to the assessee at this stage.*

Cases referred to:

CALIFORNIAN COPPER SYNDICATE v. HARRIS [1904] (5 T.C. 159; 6 F. 894).

CHUNILAL KALYANDAS, *In re* [1925] (1 I.T.C. 419; I.L.R. 47 All. 368).

COMMISSIONER OF INCOME TAX, BURMA v. J. I. MILNE [1934] (7 I.T.C. 67; 1934 I.T.R. 25; I.L.R. 11 Rang. 454; A.I.R. 1934 Rang. 4).

COMMISSIONER OF INCOME TAX, BENGAL v. SHAW WALLACE & Co., [1932] (6 I.T.C. 178; 59 I.A. 206; 136 I.C. 742; 36 C.W.N. 653; 34 Bom. L.R. 1033; 63 M.L.J. 124; A.I.R. 1932 P.C. 138; 1932 Comp. Cas. 276).

MAHARAJKUMAR GOPAL SARAN NARAIN SINGH v. COMMISSIONER OF INCOME TAX, [1935] (A.I.R. 1935 P.C. 143; 8 I.T.C. 340; 1935 I.T.R. 237).

NORTHERN ASSURANCE CO. v. RUSSELL [1889] (2 Tax Cas. 571; 26 Sc. L.R. 330).

PUNJAB NATIONAL BANK v. EMPEROR [1926] (2 I.T.C. 184; 7 Lah. 227; 27 P. L. R. 416; A. I. R. 1926 Lah. 373; 96 I.C. 380).

TATA INDUSTRIAL BANK, LTD. *In re* [1922](1 I.T.C. 152; 24 Bom. L.R. 188; 46 Bom. 567; A.I.R. 1922 Bom. 75; 66 I.C. 979).

THEW v. SOUTH WEST AFRICA CO. [1924] (9 T.C. 141; 131 L.T. 248).

WESTMINSTER BANK, LTD. v. OSLER [1932] (17 T.C. 381; 1 K.B. 668; 101 L.J.K.B. 292; 146 L.T. 441; 1933 I.T.R. 65; 1933 A.C. 139; 102 L.J.K.B. 110; 148 L.T. 41; 49 T.L.R. 43).

Case stated by the Commisstoner of Income Tax, Punjab, N.W.F.P. and Delhi under Sec. 66 (2) of the Indian Income Tax Act in the matter of the assessment of the Amritsar Produce Exchange Ltd. for the year 1935-36 [Civil Reference No. 34 of 1936].

STATEMENT OF CASE.

"Case stated under Sec. 66 (2) of the Indian Income Tax Act of questions arising out of the order on appeal of the assessee, the *Amritsar Produce Exchange Limited* (Limited Company), against 1935-36 assessment.

The grounds of appeal, Appellate Order, and the questions which the assessee requires to be referred are copied in the annexure A. The questions which in the Commissioner's finding arise and properly present the contentions are included within the statement of facts below.

2. Analyses are annexed (B), of :—(i) the balance sheet and profit-and-loss account for the years ending 31st March 1933 and 1934 and 1935, and (ii) of the "divergences" between the assessee's account attributions and those which have been, and ought to have been, adopted.

The present assessment is that in respect of the account-year ending 31-3-1935, and is on a total income of Rs. 45,906.

3. A preliminary *short summary of the issues* may be convenient. (First Issue): The Company does business as a Produce Exchange and holds deposits for contracting parties, greatly in excess of its own paid-up capital. Some considerable part of the held moneys was put into Government Securities. Within the account year, one lakh's face value of such securities were sold at an accounted profit of Rs. 3,656: which profit has been assessed. The Company contends that because it was not a regular dealer in securities, this is a "capital" profit and not assessable. The contention presented for the Revenue is that although the Company was not a regular dealer in securities *ad hoc*, the nature of

the whole business makes the profit properly assessable.

(Second Issue): An earlier Company doing the same business went into voluntary liquidation, and its liquidation proceeded side by side with the current business of the re-organised Company which is the present assessee. The old Company took over from one of its debtors a property, and transferred it to the assessee; who sold it after a short time at an accounted profit of Rs. 770, which has been assessed. The assessee contends that because he was not a regular dealer in property (and has not been held to be a "Successor" to the old Company's business within Sec. 26 of the Act), this was likewise a Capital profit. The finding of fact is that the object of purchase was the realisation (re-sale): and the contention for the Revenue is that the assessee has failed to establish that the profit is one that is exempt or outside the scope of the Act.

(Third Issue): In the prior assessment, the assessee's Profit account had included credit of Rs. 8,000 interest on the holding of Securities, not actually received or receivable, computed on a *de-die-in-diem* accrual basis. Of this sum, 2,166 was computed against the period prior to purchase; and the remainder after purchase, up to the end of the period of that account. This Rs. 8,000 was in that assessment charged to income tax; and as decided by Your Lordships in *Haveli Shah* (6th May 1936) that was incorrect. The present assessment has followed the correct basis. (One of the assessee's propounded questions presents contention that it is *not* the correct basis; but I have taken this as settled against him by the case cited). The assessee contends that this amounts to a double assessment, and is therefore illegal. The contention for the Revenue is that, in issue of law, there is no specific legal right to have a correct assessment reduced by amount of a prior over-assessment: (and it is noted that it is not any issue within the scope of Sec. 13, as to change of method-of-accounting: the interest in issue being within Sec. 8 of the Act, and outside the applicability of that provision).

The assessee's contention does not separate the 2,166 and the balance; and the figures that have been considered by the Assistant Commissioner and the petition would properly require adjustment, of a fairly complex character analysed in annexure B.

It is necessary to explain, however, why under Sec. 33, I have not thought fit to put the contention out of issue by reducing the prior over-assessment. Besides the proper adjustments in reduction of the proper figure for claim already referred to

there are (as also detailed in annexure B) also certain related items which have "escaped assessment". [*Ex cautela*, I have directed the Income Tax Officer to serve Sec. 34 notice for asseessment of these; but if the present assessment be not disturbed under orders of Your Lordships, this will not be proceeded with further]. The real nett "double assessment" would properly be about 5,000. But in an appellate order (passed subsequently to that 34-35 assessment order), the Assistant Commissioner reduced the 33-34 assessment by about 16,000, on a reversal of the Income Tax Officer's finding that there had been succession to the original Company's business: the nett effect of which (as between the two parties) was that about Rs. 16,000, escaped Company super tax. I am fully satisfied that the Assistant Commissioner's decision was wrong; and although his finding must stand *in favour* of the assessee on the second issue above, and I cannot deal with the matter positively at this date, nevertheless where the question arises whether I should eliminate an erroneous over-assessment in 34-35, I deem that it is not improper to have in consideration at the same time the (greater) under-assessment resulting from the Assistant Commissioner's order, and simply to decide to let things stay as they are accordingly.

Amritsar has a number of merchants dealing in produce (mostly grain): both actual and "forward". The assessee is an association of such merchants for the better conduct of their business, in the usual form of a Merchants' "Exchange" Company. The terms of business are not actually in evidence, but it may be stated as of common knowledge, that business is only allowed to be done between the members (shareholders): they make deposits against contracts, and the Exchange holds these deposits, adjusts and balances the accounts when the contract matures, and charges commission at settled rates on each such contract handled.

It may be as well to note that there is no contention of the kind dealt with in re *a similar* Company: *Hapur Chamber, Allahabad* 6-4-1936; and that if in any later assessment any such contention were raised, it would be negatived or resisted as far as might be necessary to establish that what the Company does with its members is Business and is not exempted on any version of "mutuality." It may be mentioned also that practically the full available profits, since the first year of this Company, have been disbursed as Dividends.

The business that is now being done by this Company used to be done by one styled " Sugar and Grain Merchants Banking Com

pany." The connection between the two is directly involved in the second item of present contention; and is also the explanation of my decision not to reduce the 34-35 assessment.

The old Company (started in 1929) had almost identical capital; generally comparable accounts position; the same Chairman of Directors, with a substantial number of the same directors, and almost the same share-holder-membership. It was doing the same business, in the same premises. I have no information as to why a reorganization was decided upon, but in August 1932 the new Company was floated and took over the active business from November, side-by-side with the winding up (in voluntary liquidation) of the old Company's uncompleted contracts and disbursement of its assets. There was a cross-account between the two companies for such items as went to the new Company's charge; but in the circumstances, this cross-account was never large; (about half-lakh balance).

Now, in my own view, this was as plain a case of "Succession" as could be found. But in this province officers had a generally wrong understanding of the matter, of the nature which your Lordships have already seen in one case (*Dhani-Ram*, 22-4-36). They looked at the discontinuity of persons, not continuity of business done; and the Assistant Commissioner in appeal reversed on these lines the right finding of the Income-tax Officer that there was a succession.

Succession is, of course an issue of fact; and the finding of the Assistant Commissioner that there was no succession stands and has not been changed by me. But I hold that I am entitled *to have in mind* that wrong finding which led to escape of 33-34 Company super-tax in respect of about Rs. 16,000, when I am being asked to go back and remedy an over assessment of slightly *less* tax effect in 34-35 assessment. I do not see why I should draw the line, in exercise of my reserved powers under section 33 for rectifying errors of the officers with statutory duties, at the particular point where the assessee wants to draw it. If it is a matter of date, the over-assessment (16th August 1934) was actually prior to the appellate order bringing about the under-assessment. Looking at all these cases as a whole, there has been a slight under-assessment; and I intended to leave things as they are, and not deal in isolation with any particular part of their inter-connection, in assessee's favour.

6. The *first issue* relates to the profit upon selling one-lakh's face value of Government Securities in December 1934.

The proper figure for the profit is a matter coming into the "divergency" issue (third) below; but for the present purpose it is sufficient to take the figure actually appearing in the profit-and-loss account, Rs. 3,656.

The Balance Sheet analysis (annexure B) will need to be had in mind. The old Company had its "Resources" (to use the Banking term) of 5 to 9 lakhs partly in Fixed Deposits, partly in Treasury Bills. The new Company in its first Balance Sheet (March 1933) had the whole six lakhs in Fixed Deposit. In October 1933 it put three lakhs of this into Government Bonds. In December 1934, it realised one lakh of these Bonds (and in March 1935 had approximately that amount extra in liquid form). It is the profit on that realisation which is in issue.

7. The orders refer to subsequent realisations of the remaining two lakhs, and the petitioner says there is some error of date about that. The Assistant Commissioner also said that there was no "need" for realisation: and the petitioner replies that there was such need because, at the time, *one of* his current accounts was in overdraft. As will be explained below, nothing could be more conclusively against him than his own version that he did effect the realisation because of business need. But I do not think it necessary to clear up these points of fact, beyond stating that the assessee had throughout full cover for all his excess of liabilities due and actual liquid cash to meet all cash-dues maturing.

8. Now, the true reason why the profit on this realisation is properly to be credited (as indeed it was credited) to Revenue, is to be found in the ratio decidendi of the Insurance and Banking cases. It has nothing to do with the question whether the assessee is a dealer in Securities as such; and it is patent that this assessee was *not* "dealing in" them as a trade of itself; but unfortunately that is the basis on which the Income Tax Officer and Assistant Commissioner found the profit assessable. I have to consider whether the proper basis can be stated before Your Lordships without first setting aside the appellate Order and guiding the Assistant Commissioner to the right issues. That course could only result in delay and needless trouble to all concerned; and it is plain that there is only one finding possible in the case. If Your Lordships consider that the proper basis cannot be brought into statement under Sec. 66 (2), then (as in various United Kingdom cases of remit) the case should be remitted for findings by the Assistant Commissioner accordingly. But even so the

issues can be now treated as referred under Sec. 66 (1) and unless the assessee himself asks to be troubled with a futile formality, objection of this kind may perhaps be waived.

Perhaps *Punjab National Bank* v. *Emperor* with *Tata Industrial Bank Ltd.*, dealing with *write-down* claims, stops short enough to be misleading. But really it is incontestable law that the *realisations* of their investments by Banks and Insurance Companies come into taxable account. For Insurance Companies it is settled in *Northern Assurance Co.* v. *Russell*; and it has never been doubted in the case of Banks (as to which the only cases are those like *Westminster Bank Ltd.* v. *Osler*, where the sole question was what constituted "realisations"). Of course, on the other hand as in 8 I.T.C. 395—and 12 T.C. 483 and 494, etc., simile (?) these cases explaining that the essence of the issue in this class of case is one of fact—it is equally incontestable that when part of a trading assessee's own capital moneys goes into any form of "fixed" assets which are not part of what he is dealing in (even though "connected with" the trade), those are not in revenue account. The line of demarcation is explained in the Insurance leading case, namely, that when a person is (like the present assessee) dealing not in goods but in money, and is taking from his customers money, and has to hold that money as part of his business, and does so in ordinary business course in the form which is most profitable having in mind security and the requisite degree of liquidity, then *all his dealings* in that money lie in revenue account; but (as in the Bank case) the investments should *not* be treated like stock-in-trade and be stock valued, but only be brought in when there is actual "realisation" in some form.

10. Questions of "capital or revenue", and of proper account attribution are issues not primarily of law but of fact—cf., e.g., *Whelan* v. *Dover Harbour Board* and *Sun Insurance Office* v. *Clark*. Where there are profits, the onus of showing that they lie outside the charge must lie on the claimant.

If the question be of "any material", the assessee's own attribution to profit is some material (as in the leading case on "Remittances", *Scottish Mortgage Co.* v. *McKelvi*) even though there are dicta to the effect that *rights* of the revenue do not depend one way or the other on mere book-keeping. The assessee suggests that on the other hand his description of his Resource as "Investment" is conclusive in his favour. The real evidence lies in the Balance Sheet figures as they stand; and it is incon-

testable that in fact the assessee was dealing in money, not goods: that his holdings of customers' moneys resulted in a held balance of roughly seven lakhs against less than a lakh of own capital, and that the form in which he held this excess was dictated by the needs of his actual business (and was not an investment of own savings).

I think the proper question arising is :—

First Question ;—"Was there no material enabling a finding that the proper account attribution for the profit on sale of Government Securities within the account period was in Profit-and-Loss (and not to capital) account ?"

In the Commissioner's opinion not only there was material: no competant person could conceivably come to any other conclusion.

11. The *second issue* relates to a property taken over by the old Company from a debtor against his debt, and then taken over by the present Company for realisation, and actually realised as profit.

Had the present Company been held to be a successor in fact, the issue would presumably fall to be decided on the same principles as if it had handled the whole transaction. The Case law as to foreclosure-accounting is not very consistent or clear in India: but I think the question whether anything taken over comes into capital or revenue account would depend upon evidence of intention at take over—whether the evidence indicated an intention to hold or to realise as early as sensibly practicable. On that footing, I think this profit would certainly have appeared taxable: but as the actual finding has not been of Succession (and the relations with the old Company only appear as an item of evidence in considering what the present Company was really doing), considerations different, and more favourable to the assessee, apply.

There are no evidenced particulars of the dealings between the Old Company and its debtor: or of when it took over this property from him. All that lies in evidence is the fact of take over by the present Company, at a cost-figure of Rs. 8,031 brought into its 1934 Balance Sheet. Then the item goes out of the 1935 Balance Sheet and 770 is taken to Profit-and-Loss account as "Profit on Sale of Property." The assessee claims that this is a "capital, casual and non-recurring" gain, because (he says) "there is no sufficient evidence to hold that he did invest money in the building with the intention of doing business in buildings."

12. The matter of "depreciation claim" and some alleged interim use for storage—I gather, of stationery—pending the re-sale, is dealt with in the appeal order. The ultimate finding is that "the object of purchase was re-selling at a profit as soon as a suitable opportunity arose."

The tax in issue (on Rs. 770) is comparatively small; and I think the finding, as it stands, is adequate for the purpose.

13. The theoretical aspect of this matter is comparatively difficult. I do not know whether the proper touchstone to be applied is a general consideration of what is or is not income; or the specific exemption clause Section 4 (3-vii) which seems to aim at defining what is not income; or some combination of both.

In *Mercantile Bank* (*Yule Trustees*) the Privy Council seem to prefer the general consideration: but even then the United Kingdom cases up to 18 T. C. 680, and Lord Macmillan's comprehensive summary in 19 T. C. 390, hardly seem to me to get much further than saying that that consideration is one to be settled on principles which "no commercial man would misunderstand", but which cannot be successfully crystallised in words. Then there is the difficulty that some Indian decisions have distinguished "profits or gains" (Section 4-1) as an enlargement of the single word Income. And in 8 I.T.C. 320 the Madras Chief Justice mentioned the difficulty about the dictum at 6 I.T.C. 180 (in regard to the series of "Single Transaction" cases).

On the other hand, a great many profits that certainly are capital could hardly be described as "casual" in the ordinary sense of that word—for instance the surplus derived from prudent investment is not what most of us would so describe. And there is a sense in which no profit can ever be other than "non-recurring."

I suggest without further expanding the theory, that where there is a profit and its exclusion is contended for, it is *for the assessee to establish* either that it was an accretion of his invested assests, not acquired with the primary object of yielding a surplus on realisation (but primarily as a means of bringing in its recurrent fruit); or else that it was a mere windfall not arising from any special activity on his part. And that in deciding on which side of a difficult border-line any particular item lies, connection with the assessee's regular trade is a relevant consideration.

14. The question of law for Your Lordships' resolution seems to me to be only—

Second Question.—"The only relevant evidence in respect of

the profit on sale of property being that the said property was acquired in connection with the business of the assessee for the purpose of realising moneys, and that this realisation was actually effected within a short time of acquisition, was this such conclusive proof of the profit being outside the scope of the Act, that, as a matter of law, the Assistant Commissioner could not hold that this was not proved?"

In the Commissioner's opinion the answer is that this was not so proved.

15. *The third issue* involves for reconciliation of the actual figures, fairly close analysis of the details of account; and this is given in the Annexure. Here I will try to deal with the generality of the problem.

It is commonplace that a business-man's account for his own purposes is not by any means certain or even likely to be the requisite account for the purposes of the Act. Section 13 does give considerable latitude in regard to "Business"; and for whatever does lie within charge of Section 10, a computation at the end of account, of *de-die-in-diem* accrual, is a method of account that could hardly be diverged from, as far as that goes.

In the assessee's first Balance Sheet (and of course correspondingly in his Profit-and-Loss account) he dealt with his Fixed Deposits, and possibly with other accounts, on a computed accrual footing. He has slightly improved the placing in subsequent Balance Sheets, but the essential treatment has continued, and has been acquiesced in.

But what has not been acquiesced in, this year, is a like treatment of the Interest chargeable not under Section 10, but under Section 8.

16. His *de-die-in-diem* accrual-computations come into account in two ways. First, there is the *purchase-and-sale* figure, of the same nature as in the Haveli Shah case. The assessee has been putting such "accrual" (with a still further complication of a computation of income-tax-at-source proportionate deductions, and also an indefensible attribution of Bank Commission on these transactions to the Interest account) into Profit-and-Loss account.

Secondly, he has been taking the like computed accruals on his *holdings*, into his interest account.

17. The first matter stands as a simple issue of figures, after Your Lordship's Haveli Shah decision. Leaving aside the subsidiary complications for the moment, the position is that at purchase in the previous account Rs. 2,166 of which *some part* is

attributable to the present sold item, was wrongly credited to Interest account. But now, at time of sale, the Income-tax Officer has correctly brought in the like item, in the sale price of which the profit is the subject of the first issue.

18. As to the second matter, again eliminating the minor complications, the position is that Rs. 5,834 was put to Interest account last year; quite properly for assessee's own purposes, but he returned* it incorrectly for the purposes of the Act, and it was assessed.

Now, a like erroneous attribution has been rightly excluded by the Income Tax Officer, who has assessed only the interest properly assessable (as received) under Sec. 8.

The assessee claims to deduct Rs. 8,000 which is the total of these two different types of "divergence" in the previous year's credits.

19. He does not apparently now contend that he is entitled to adhere to the *de die in diem* basis on these items; and I need say no more about that than :—

(a) Even though as above the investment-realisations come into Revenue accountability, that does not make them in any way part of Revenue Stock account, for reasons explained in the "Realisation" cases. The Sec. 8 income is not made Sec. 10

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* The assessee's reply to the Statement in draft includes objection to the statement that he returned this sum. I have noted on this as follows :—

"The assessee's 34-35 Return at page 9 of the miscellaneous Record brings in the Profit-and-Loss account total, including the 8,000 in issue. This is then deducted against the heading in the prescribed form for items "already charged to tax" (and there is a contra-item as shown in Annexure B for tax-at-source computed to be deductible thereon). Because it had not, in fact, been already so charged, the Income Tax Officer did not acquiesce in this deduction. The assessee appealed on other matters, but not on this.

He seeks to represent that it is incorrect to describe him as having "returned" the amount; and to say that it was an erroneous addition by the Income Tax Officer. I think the description of his actions as returning the amount is correct; and, in any event, it is irrelevant to the question put, whether the actual over-assessment in that year has the legal effect of necessitating a correspondingly incorrect under-assessment, in the assessment in present issue of law."

income by reason of this view about the principal amount.

(*b*) As a practical matter, there may be cases where difficulty of any divergence from assessee's account to a theoretically right account, excuses an acceptance of assessee's account as it stands. But here, where there is this contest about the principal amounts, and there have been these misattributions between capital and income account, I could not approve of any such connivance.

20. Hence, the case is simply one of claim to reduce a correct assessment by the amount of assessee's own over-credits to his returned accounts in the past: the two parts of the over credit being of the different characters detailed above; and there being also over-debits which he says nothing about.

(These, however, would not altogether wipe out the excess).

The question arising seems to me to be :—

Third Question :—"The assessee having in past assessment erroneously attributed part of the cost of an asset other than stock-in-trade to Interest account, and having also returned "Interest on Securities" in excess of what was actually then receivable and chargeable under Sec. 8, is he entitled as a matter of law to have his current assessment reduced by the over-assessment (or by any detail entering into that over assessment)?"

In the Commissioner's opinion, he has no legal right of this character; (and although he ought ordinarily in such circumstances to have his prior assessment corrected, it is not wrong to refuse to deal with such correction when there stands in subsequent record what in the Commissioner's finding is an approximately equal under-assessment which cannot be specifically enhanced).

Kirpa Ram Bajaj for the Assessee.

S. M. Sikri for *J. N. Aggarwal* for the Commissioner.

JUDGMENT.

DIN MOHAMMAD, J.—Under Sec. 66 (2) of the Indian Income Tax Act, the Commissioner of Income Tax has referred the following three questions to us:

(1) Was there no material enabling a finding that the proper 'account-attribution' for the profit on sale of Government Securities within the account period was to profit and loss (and not to capital) account?

(2) The only relevant evidence in respect of the profit on sale of property being that the said property was acquired in connection with the business of the assessee for the purpose of

realising moneys, and that this realisation was actually effected within a short time of acquisition, was this such conclusive proof of the profit being outside the scope of the Act, that as a matter of law the Assistant Commissioner could not hold that this was not proved?

(3) The assessee having in past assessment erroneously attributed part of the cost of an asset other than stock-in-trade to interest account, and having also returned "Interest on securities" in excess of what was actually then receivable and chargeable under Sec. 8, is he entitled as a matter of law to have his current assessment reduced by the over-assessment (or by any detail entering into that over-assessment)?

The facts bearing upon the first question formulated by the Commissioner are these. The assessee does business as a Produce Exchange and receives a large amount of deposits from his clients in the course of his business. These deposits he had invested in Government Securities and in the accounting period he sold these securities in profit. A question arose whether this profit was on capital account or on revenue account and it is this question that has been formulated by the Commissioner in the form indicated above. The controversy existing between 'capital' and 'revenue' has defied solution so far and it is difficult, therefore, to lay down any general considerations which would conclusively determine whether a certain income falls under one head or the other. In this case, however, it is more a question of fact than of law and it is on that basis that we propose to decide the matter at issue. It is not even denied by the assessee that the deposits that were invested in the shape of securities represented the moneys received by him from his clients in the course of business and the burden lies on him therefore to prove that the profits realised therefrom could not be charged to income tax.

Counsel for the assessee contends that the investment in question was in the nature of 'fixed capital' and not in that of 'stock-in-trade', and consequently the profits realized from the securities could in no way form part of his profits or gains of business as contemplated by Sec. 10 of the Income Tax Act. He has further urged that the profit realized from these securities is covered by the exemption provided in Sec. 4 (3) (vii) and that as these profits are of a casual and non-recurring nature, the Act does not apply to them. In support of his contention, he has relied on *Tata Industrial Bank, Ltd., In re*, *Punjab National Bank* v. *Emperor*, *Commissioner of Income Tax, Bengal* v. *Shaw Wallace &*

Co. and *Commissioner of Income Tax, Burma* v. *J. I. Milne.* But in our view, these authorities are not applicable in this case.

In *Tata Industrial Bank, In re*, a banking concern claimed to deduct from the taxable profits a certain sum which represented the amount of depreciation on war bonds and securities belonging to it. A Division Bench of the Bombay High Court held that that deduction could not be allowed under Section 9 of the Income Tax Act of 1918 (corresponding to Section 10 of the Income Tax Act of 1922). The *ratio decidendi* of that judgment was that the assessing officer was not entitled in his discretion to allow any deduction for sums paid or debited other than those properly paid and debited as detailed in sub-section (2) of Section 9. It would be observed that that judgment does not touch the points awaiting solution before us. Section 10 of the present Act which corresponds to Section 9 of the old Act does expressly mention certain deductions which are permissible, and whenever a deduction is claimed an assessee is bound to bring his case under one clause or another. Here, the assessee has put forward a claim not for deduction but for exclusion on the ground that the income earned by him cannot be computed in calculating his total taxable income and the question whether a certain income is or is not profit or gain within the meaning of sub-Section (1) of Section 10 has nothing to do with the deductions permissible under sub-Section (2) thereof. Counsel for the assessee, however, urges that the converse of the principle laid down in the Bombay judgment holds good in the present case, but we do not agree with him. That judgment did not deal with the question of profits and concerned itself only with the point whether a certain deduction fell within the four corners of Section 9. It will not, therefore, be a safe guide in this matter.

In *Punjab National Bank* v. *Emperor* the Punjab National Bank Limited had invested some moneys in Government securities and claimed deduction on account of some depreciation in the value of those securities. A Division Bench of this Court disallowed the claim on the ground that the investment in question represented ' fixed capital ' and not 'floating capital,' of the Bank. The learned Judges remarked, "It cannot be denied that the Bank purchased these securities not for the purpose of trading in them but for the purpose of retaining them permanently for use in an emergency. It is the practice of all properly managed Banks to invest a portion of their capital in high class securities in order to have a readily available supply of cash in a crisis. Those secu-

rities were not held by the Bank as floating capital; they were not held by the bank with the object of being dealt in day by day in the ordinary course of business. They were held as an emergency reserve and regarded as the equivalent of ready cash with this considerable advantage over ready cash that they brought in a small but secured amount of interest." A superficial reading of the judgment no doubt supports the contention of the assessee to some extent but in our view what the judgment intends to lay down is that in every case it is to be determined on its own facts whether the investment was a part of the ordinary business of the investor or otherwise. If it could be found that an investment had been made for the purpose of permanently excluding a certain sum from the floating capital of a concern, it might be permissible to hold that that sum was intended to serve as a reserve or, in other words, as fixed capital having no concern with the stock-in-trade. If, on the other hand, the facts relating to that investment unequivocally point to the conclusion that the investment is to all intents and purposes a part of the business and that the sum so invested is intended to serve as stock in-trade, the profits arising therefrom will form part of the income of the concern. If the learned Judges, however, intended to lay down a rule of general application that in every case an investment in the shape of securities made by a concern should be treated as fixed capital, we respectfully beg to differ from that conclusion. In our view, a sweeping assertion of that nature would be altogether opposed to law.

In *Commissioner of Income Tax, Bengal* v. *Shaw Wallace & Co. Ltd.*, the question before their Lordships of the Privy Council was whether a sum of money received as compensation for loss or cessation of an agency was not income, profits or gains within the meaning of the Income Tax Act, and their Lordships came to the conclusion that it was not. "Income did not include receipts of any kind which were not specially exempted under the Act," and the 'object of the Indian Act is to tax' 'income' which is expanded into 'income, profits and gains' though the expansion is more a matter of words than of substance". In their Lordships' view, "income in the Indian Income-tax Act connotes a periodical monetary return, coming in with some sort of regularity or expected regularity from definite sources. The source is not necessarily one which is expected to be continuously productive but it must be one whose object is the production of a definite return excluding anything in the nature of a mere wind-

fall ". Their Lordships further thought that the expression 're-ceipts' arising from business as used in Sec. 4 (3) (vii) meant receipts arising from the carrying on of business. We are in respectful agreement with the principles laid down by their Lordships of the Privy Council, but we fail to realise how they help the assessee. As indicated above, in every case that arises it is to be determined whether a certain profit is in the shape of a windfall or it is a part of a periodical monetary return with some sort of 'regularity' or 'expected regularity' and if it is found that the assessee intended to make these profits regularly the judgment of their Lordships of the Privy Council will not stand in the way of the Income Tax Department assessing those profits. Besides, the Commissioner here contends that these profits arose from the carrying on of the normal business of the Company and if that be so the exemption claimed by the assessee will not be available to him even under the Privy Council judgment. It may further be noted that in *Maharaj Kumar Gopal Saran Narain Singh* v. *Commissioner of Income Tax, Bihar and Orissa* their Lordships of the Privy Council have observed; "The word 'income' is not limited by the words 'profits' and 'gains'. Anything which can properly be described as income, is taxable under the Act unless expressly exempted ".

In *Commissioner of Income Tax, Burma* v. *J. I. Milne* the assessee was a tin mine owner who had been lending money to a mining Engineer for working a tin area. He made a further advance to him of a considerable amount of money under an agreement stipulating for payment of a share of the price of the mining area then contemplated to be sold and received a large sum of money under the agreement. The Income Tax Department contended that the profits made by the assessee were taxable. The assessee, however, resisted it on the ground that they did not form part of a regular business. It was held by a Division Bench of the Rangoon High Court that these profits were covered by Sec. 4 (3) (vii) of the Income Tax Act. Page C.J. who delivered the principal judgment remarked, " It does not appear to me that it was a business transaction in any sense, but was only a mode by which the assessee sought to secure himself against loss if he lent to Mr. W. S. this further sum of Rs. 10,000. . . . it is clear to my mind upon the face of the agreement that the transaction out of which the £ 6,000 accrued to the assessee formed no part of any business that the assessee was carrying on. ......the transaction was a receipt, not being a receipt arising

from business, of a casual and non-recurring nature within Sec. 4 (3) (vii) of the Act". With the principles underlying these remarks we are in respectful agreement, but the question still remains whether they apply to the case before us.

On behalf of the Commissioner, on the other hand, reliance has been placed on 6 I. T. C. 74, *Chuni Lal Kalyandas, In re, Northern Assurance Co.* v. *Russel, Westminster Bank Ltd.* v. *Osler, Thew* v. *South West Africa Co. Ltd.* and *Californian Copper Syndicate Ltd.* v. *Harris.*

In 6 I. T. C. 74, the assessee had purchased a plot of land with the idea of parcelling it into small plots and selling them as building sites at a profit and he sold some plots in furtherance of this intention. Later, the land remaining unsold was acquired by Government on payment of compensation. The Department assessed the profits which had thus accrued to the assessee and the assessee contested their right to do so. It was held that the transaction was an adventure in the nature of trade coming within the definition of 'business' in Sec. 2 (4) of the Income Tax Act and that the receipts from the sales were profits of business and not casual receipts exempt from assessment.

In *Chunilal Kalyan Das, In re,* the assessee who was once in regular business as a cloth and grain merchant which he had given up received a sum as brokerage for the sale of certain mills and this brokerage transaction was an isolated one in the year of assessment. On a question raised by the assessee that the sum as received by him was not assessable to income tax as it fell within the meaning of Sec. 4 (3) (vii) of Income Tax Act, a Division Bench of the Allahabad High Court decided against him and held that the transaction came within the definition of 'business' and was not therefore exempt under Sec. 4 (3) (vii). The learned Judges in the course of their judgment remarked, "In taking the view we do, we found ourselves mainly upon the use of the word 'nature' in the exemption. The word is not 'occurrence'. If the language were 'a casual or non-recurring occurrence' there would be much to be said for the contention of the assessee. But the expression 'nature' appears to us to be a word used independently of the accident of the event happening in fact once only or more often in a fortunate year. It connotes a class of dealing which might occur only once, but which might occur several times. Now the adventure of a businessman who is enabled throughout his business associations to negotiate a large transaction and thereby to earn a heavy commission, may undoubtedly be

in fact non-recurring in the sense that so successful an adventure would not be likely to occur again. But, on the other hand, it is a class of transaction which might occur to any such businessman once only or half a dozen times again, during the course of the year".

In *Northern Assurance Co.* v. *Russell*, the Lord President remarked, "where the gain is made by the Company by realising an investment at a larger price than was paid for it, the difference is to be reckoned among the profits and gains of the Company".

In *Westminster Bank Ltd.* v. *Osler*, certain Banks converted their holdings of National War Bonds into 5 per cent. War Loan and 3½ per cent. Conversion Loan, the value of the stocks received in exchange being greater than the cost to the Banks of the National War Bonds converted. It was held by ROWLATT, J., "they have got a new thing and at the moment they get it they have got something which is worth more than that which is represented in their books as the thing they got it for. That is the whole of it, and it seems to me that for the purpose of arriving at this system of making profits, which is a perfectly proper system, there is a profit here, and therefore the Crown must succeed in this case".

In *Thew* v. *South West Africa Co. Ltd.*, it was held by the High Court of Justice (King's Bench Division) that any profits derived by the Company from sales of land must be taken into account in computing for income tax purposes the profits arising from the trade, adventure, or concern in the nature of trade exercised by the Company. Pollock, M. R., observed, "The question that we have to determine is whether the moneys derived from those sales of land fell into income or are to be treated as capital of the company. That is the question which often gives rise to difficulties and gives rise to different opinion. We have to decide upon the substance of the case and not upon what any individual company may deem the particular item in the course of its trading...I think the Company could, if they pleased, deal with the proceeds of the sale of land either as capital or in profit and loss account according as they determined to be right...The facts are not for us; the facts are for the Commissioners who had the case before them".

In *Californian Copper Syndicate Ltd.* v. *Harris*, it was held that the difference between the purchase price and the value of the shares for which the property was exchanged is a profit assessable to income tax. There the assessee which was a company

formed for the purpose, *inter alia,* of acquiring and reselling mining property had after acquiring and working various properties resold the whole to a second Company receiving payment in fully paid shares of the latter Company.

The assessee contends that the English authorities are not of much help in the solution of the problem before us. As remarked by their Lordships of the Privy Council in 6 I.T.C. 178, "The Indian Act is not in *pari materia*; it is less elaborate in many ways, subject to fewer refinements and in arrangement and language it differs greatly from the provisions with which the Courts in this country have had to deal. Under such conditions their Lordships think that little can be gained by attempting to reason from one to the other, at all events in the present case in which they think that the solution of the problem lies very near the surface of the Act, and depends mainly on general considerations". This is true and we propose, therefore, that the decision of this case should proceed on its own facts and in the light of the Indian judgments, if any. We, however, consider that the English judgments can be utilised as aids in the interpretation of analogous provisions of law though not as binding authorities on those matters where the language of the English and Indian Acts differ.

The word 'business' has been defined in the Indian Income Tax Act as including 'any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture." The term 'total income' has been defined as meaning "total amount of income, profits and gains from all sources to which this Act applies computed in the manner laid down in Sec. 16." Under Sec. 6 those headings of income have been enumerated which are chargeable to income-tax and under Sec. 10 sub-Sec. (1) it is provided that the tax shall be payable by an assessee under the head 'business' in respect of the profits or gains of *any* business carried on by him. Sec. 4 (3) (vii) exempts only those receipts which are not receipts arising from business or the exercise of a profession, vocation or occupation and are of a casual and non-recurring nature. The combined effect of all these provisions of law appears to us to be this: If exemption is claimed for any item of income received by an assessee, it is for him to show that the receipt does not arise from business and is of a casual and non-recurring nature. If he fails to prove either of these alternatives, he cannot bring his case

within the purview of Sec. 4 (3) (vii) and he will be liable to pay income tax on the item of income so received.

We have already indicated that the business of the assessee was a quasi-banking business and it received moneys from its clients for the purposes of the business. It is further clear to us that the investments that had been made had also been made as a part of the same business and the receipts arising therefrom were to all intents and purposes receipts from business. In these circumstances, even if the receipts were of a casual or non-recurring nature, they will not be covered by Sec. 4 (3) (vii). Apart from this, it is the intention of the assessee that is to be considered in such matters and when once it is found by the Department as a matter of fact that the assessee's intention was to make profits from these investments as a part of the assessee's business, it is doubtful whether we can go behind that finding. On these grounds, our reply to question No. 1 will be in the affirmative.

The second question need not detain us long. The property in question had been taken over by the old Company from a debtor in discharge of his loan, and the new Company realized profits out of it. As remarked by the Commissioner, the question whether anything taken over comes into capital or revenue account would depend upon evidence of intention at the time. The finding at which the Department arrived was that "the object of purchase was reselling at a profit as soon as a suitable opportunity arose." The assessee has failed to establish that the property was not acquired with the primary object of yielding a surplus on realization or that it was a mere windfall. We accordingly answer this question in the negative.

Coming now to question No. 3, it is admitted by the Department that the assessee was in the habit of compiling his account on the strictly mercantile basis even with regard to the interest on securities. The interest due on the securities was accordingly brought into the profit and loss statement last year even though it had not been actually received. The Income Tax Officer, however, adopted the cash basis in the present year and assessed the amount actually received by way of interest. The procedure adopted by the Income Tax Officer will no doubt result in double assessment but whether this is illegal or not will depend on the true interpretation to be put on Section 48-A (1) and (2). Further, that Section comes into play only when the income tax has been actually paid in excess and not earlier and we have not been referred to any other provision of law which we can invoke

at the present stage of the assessment to grant to the assessee the relief prayed for. We are consequently constrained to answer this question too in the negative.

We answer the three questions referred to us accordingly and order the assessee to pay the costs of the Commissioner.

[IN THE LAHORE HIGH COURT.]

MELA MAL SHIV DAYAL

v.

COMMISSIONER OF INCOME-TAX, PUNJAB.

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

November 26, 1936.

ACCOUNTING—'PREVIOUS YEAR'—ASSESSEE ADOPTING *Sumbat* YEAR FOR HEAD OFFICE AND FINANCIAL YEAR FOR BRANCHES—RESULTS OF TWO YEARS OF BRANCHES CANNOT BE BROUGHT WITHIN ONE PREVIOUS YEAR OF HEAD OFFICE—INDIAN INCOME-TAX ACT (XI OF 1922), SEC. 13—INCOME TAX MANUAL, PARA. 6 (VIII).

Though, in view of the instructions contained in the Income Tax Manual an assessee is entitled to have two 'previous years', one for the head office and one for the branches, he cannot incorporate two years' results of the branches in one year's account on the ground that the two years' results of the branches happen to come within one previous year of the head office.

Case stated by the Commissioner of Income Tax, Punjab, N.W.F.P. & Delhi, under Sec. 66 (3) of the Indian Income Tax Act as directed by the High Court of Lahore in its order dated February 10, 1936 (reported at 1936 I.T.R. 206), in the matter of the assessment of Messrs. Melamal Shiv Dayal for the assessment year 1932-33. [Civil Reference No. 19 of 1936].

STATEMENT OF CASE.

"Case stated under Section 66 (3) of the Indian Income Tax Act, as required by the High Court of Judicature in Miscellaneous Side Civil Case No. 620 of 1933, referring question of law arising from the appeal of the assessee Hindu Undivided Family styled Mela Mal Shiv Dayal, in the matter of 1932-33 assessment."

2. The question required by your Lordships to be referred is :

"Whether in the circumstances mentioned above, the losses of the branches ought to have been allowed in the assessment year 1932-33."

In para. 4 of my order refusing the original application for reference, it was pointed out that the actual result (whether loss or profit) of the businesses and periods in issue had not been determined; and it is submitted that the question may be changed to the form

"Whether the loss or profit of the branches in the year ending 31-3-31 ought to be determined and brought into account in the assessment for the year 1932-33."

3. The "circumstances mentioned" may be thus extracted from Your Lordships' Order :—

"........the Head Office of the assessee firm is at Hoshiarpur and they also carry on business at Ferozepore, Mahalpur, Hariana and Moga. The accounting period of the Head Office is the *Sambat* year from Chet Sudi 1 to Chet Badi 15. The length of the *Sambat* year is not constant, and sometimes it extends over two dates of the 31st March, and sometimes it does not include even a single date of the 31st March. The accounting period of the branch offices which mainly deal with excise contracts is from the 1st of April to the 31st March, that is, the ordinary financial year. According to the assessees there was a loss at the Ferozepore excise branch amounting to Rs. 2,062 and at Mahalpur, Hariana and Moga branches amounting to Rs. 4,663 during the accounting period 1st of April 1930 to 31st of March 1931. The accounting period of the Head Office for the assessment year, 20th March 1931 to the 5th April 1932, happened to correspond to the period from the "30th of March 1930 to the 19th of March 1931." As the accounting period of the Head Office ended before the accounting period of the branch offices came to an end, the losses of the branch offices during 1930-31 were not shown in the Head Office accounts dealing with the accounting period "30th of March 1930 to the 19th March 1931." In the assessment for the year 1932-33 the losses referred to above were sought to be claimed as they could not have been claimed in the previous year, as the accounting period of the Head Office ended before the accounting period of the branch offices had come to an end."

4. As the contention is mainly related in the remainder of Your Lordships' Order to "Regular Method of Account" it is necessary to add the following facts, (taken from my order of refusal already mentioned), thus :—

"For several years prior to 29-30 this assessment had been made in respect of businesses regularly accounted by the *Sambat* Year the length of which varies, and sometimes extends over two dates of 31st March (English): sometimes does not include one at all. In 29-30 some Excise businesses were brought in for the first time. Although the Miscellaneous Record is available, neither it nor the Assessment Record shows exactly what was included (what period); nor explains how these new items came into the case, but in respect of one very small detail of Hariana (No. 8) it is mentioned that both the Excise (financial) years fell in this *Sambat* period. The implication seems to be that results of two Financial years were being brought into the period.

2. The 30-31 order (heading) misstates the account period, but in its contents notes that Excise losses for the year ending 31st March 1930 did not end in this Sambat year and would be claimed in the following year.

3. The 31-32 assessment was an undetailed estimate under Sec. 23 (4), and the Income-Tax Officer (erroneously) gave the account period as the previous financial year. There was a similar error in an initial assessment under the same provisions for 32-33; but subsequently the accounts were seen and a probable income larger than the estimate was established. Action was taken for assessing this under Sec. 34 in this present order. It again misstates the period in the heading, but gives separated details in the text of order, and takes the central accounts for the *Sambat* year running 20th March 1931 to 5th April 1932.

4. The items in issue are claims of loss in Ferozepore branch (Rs. 2,062) and Mahalpur, Hariana and Moga branches (Rs. 4,663) in the twelve months ending 31-3-31. I cannot see what happened about Ferozepore for the period ending 31-3-31, but the other branches for that period were brought in to reckoning."

5. Relevant exracts from the Assessment Order are annexed, Annexure A.

The grounds of Appeal are copied as Annexure B. Those directly relevant are Nos. (6) and (7) with (12); but further light is thrown upon the nature of the present contention by comparative consideration of Nos. (8) to (11).

It may be noted that although the 31-32 Moga account is brought in only as a 5-8 share, and the Phillaur account as a 3-4 share, it has nowhere been contended that these were separate Partnerships. They are treated throughout as Branches, distinct from the Shares-in-Firms which also came into the case; and

deduced therefrom, with reference to Sec. 13 proviso. This is the gist of the Income-tax Officer's decision on the claim, and of itself that decision is not a subject of law (7 I.T.C. 372 etc.).

The assessee however in his second question says that his method has been "accepted from year to year". The above history will show that this is not correct. In any event, it is settled law that there is no *res judicata* bar in these matters. What the assessee might contest on fundamental principles is that the treatment followed in one year could not be changed without allowance for the effect of change: *e.g.*, that the decision in 30-31 could not be diverged from in 31-32 without allowing the amount excluded in the 30-31 treatment. But there is no means of showing that there was any such erroneous treatment in the 31-32 estimate here relevant.

11. In the Commissioner's opinion, the answer to the question is in the negative."

Kirpa Ram Bajaj, for the assessees.

J. N. Aggarwal, S. M. Sik[illegible] *M. M.* [illegible] for the Commissioner of Income Ta[illegible]

JU[illegible]

A Division Be[illegible] sioner of Income Tax to [illegible] amily, Mela Ram Shiv [illegible] same time formulated [illegible]

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[illegible]

Executive Notes and instructions regarding the Income Tax Law and rules at page 148 of the Income Tax Manual. This executive instruction runs as follows:—

"If an assessee closes his accounts in different dates for different businesses or different sections of the same business, or different sources of income, his income should be calculated separately for each business, section of business or source, according to the accounting year adopted for it and the aggregate of the income thus computed should be treated as the income of the previous year. Each of the years of which the income is thus added together must, of course, satisfy the definition of 'previous year' in Sec. 2 (11) of the Act with reference to the same year of assessment".

Whether this instruction is in accorance with law or not, is not very important as the assessee would be entitled to take advantage of it if it is in his favour, seeing that it has been published for general information. The scheme of the Act and the definition of "previous year" would, however, seem to show that there can be only one previous year in one assessment. The Income Tax Commissioner has remarked that he had no desire to go against the instruction embodied in paragraph 6 (viii), but he says that the concession allowed by it does not mean that the assessee can incorporate two years' results of the branches in one year's account on the ground that the two years' results of the branches happen to come within the previous year of the main office. This is actually what the assessee is contending for. As we read this instruction it means that under it the assessee is entitled to have two 'previous years', one for the Head Office and one for the Branches, but in his assessment he must add the results of the two each year and make his return on this basis. He cannot accumulate the results of two years of the branches and account for them in one year's results of the main office.

For the reasons given we answer the question in the negative and allow the Commissioner his costs.

Question answered in the negative.

[IN THE LAHORE HIGH COURT]

SOMCHAND MALUK CHAND
v.
COMMISSIONER OF INCOME TAX, PUNJAB.

TEK CHAND and ABDUL RASHID, JJ.

May 3, 1937.

REFERENCE—BEST JUDGMENT ASSESSMENT—QUESTION WHETHER ASSESSMENT WAS MADE ARBITRARILY, RECKLESSLY OR CAPRICIOUSLY—QUESTION OF LAW—INDIAN INCOME TAX ACT (XI OF 1922 SECS. 23 (4), 66 (3).

Whether an assessment to the best judgment made under Sec. 23 (4) of the Indian Income Tax Act, has not been made arbitrarily, recklessly or capriciously without the Income Tax Officer exercising his 'judgment' in the matter is a question of law on which the High Court can require the Commissioner of Income Tax to state the case.

Cases referred to:

ABDUL BARI CHOWDURY *v.* COMMISSIONER OF INCOME TAX, BURMA [1931] (I.L.R. 9 Rang. 281; A.I.R. 1931 Rang. 194; 133 I.C. 81; 5 I.T.C. 352).

COMMISSIONER OF INCOME TAX, C.P. *v.* LAXMINARAIN BADRI DAS [1934] (1934 I.T.R. 246; A.I.R. 1934 Nag. 183; 31 N.L.R. 32; 153 I.C. 7) *reversed by the Privy Council in* COMMISSIONER OF INCOME TAX U.P. & C.P. *v.* LAXMINARIAN BADRIDAS [1937] (1937 I.T.R. 170; A.I.R. 1937 P.C. 133).

Petition under Sec. 66 (3) of the Indian Income Tax Act, praying that the Commissioner of Income Tax, Punjab, North West Frontier and Delhi Provinces, may be required to state and refer the petitioner's case to the High Court for orders. [Civil Mis. No. 42 of 1937].

Kirparam Bajaj, for the petitioner.

ORDER.

This is an application under Sec. 66 (3) of the Income Tax Act praying that the Commissioner of Income Tax, Punjab, be required to state and refer to this Court certain questions of law, which are alleged to arise from orders passed by the Income Tax authorities in the course of the assessment for the year 1934-35.

These questions are six in number and are set out in detail in paragraph 10 of the application. In support of his contention, that the questions raised are questions of law, the learned counsel for the petitioner relied upon a number of rulings of Courts in India, including *Commissioner of Income Tax, C.P.* v. *Laxminarain Badridas.* The decision of the Judicial Commissioners in this case, however, has recently been reversed on appeal by their Lordships of the Privy Council. [See *Commissioner of Income Tax, U.P. & C.P.* v. *Laxminarain Badridas, 1937 I.T.R. 170*]. In their judgment, their Lordships dissented from the view which had been taken in several cases in India, as to the scope of Sec. 66 of the Act, and approved of the decision of the Full Bench of the Rangoon High Court in *Abdul Bari Chowdhury* v. *Commissioner of Income Tax, Burma.*

In the light of this authoritative pronouncement, counsel conceded that questions (a) to (e), as formulated by him in paragraph 10 of the petition, cannot be regarded as questions of law, on which this Court can require the Commissioner of Income Tax to state the case.

He contended, however, that question (f) falls within the exception mentioned in *Abdul Bari Chowdhury* v. *Commissioner of Income Tax, Burma.* He pointed out that the Commissioner in his order of the 26th of May 1936, dismissing the petitioner's application under Sec. 66 to state and refer the case to this Court, has observed that the Income Tax Officer has "acted contrary to all the instructions" which the Commissioner had issued to him and other subordinates for making assessments in cases of this kind, and that, in his opinion, "the assessee has been unfairly and incompetently treated on *prima facie* merits". In view of these observations, counsel urged that the assessment has been made arbitrarily, recklessly and capriciously. It seems to us that there is force in his contention.

We accordingly require the Commissioner of Income Tax, Punjab, to state the case and refer it to us on the following points:—

"Whether in the circumstances of this case the assessment of the petitioner was not made arbitrarily, recklessly or capriciously, without the Income Tax Officer exercising his "judgment" in the matter, and is it not liable to be set aside?"

As there is no appearance on behalf of the Commissioner of Income Tax, there will be no order as to costs.

Petition allowed.

[IN THE BOMBAY HIGH COURT.]

COMMISSIONER OF INCOME TAX, BOMBAY
v.
PIROJBAI N. CONTRACTOR

SIR F. W. BEAUMONT, C. J., and RANGNEKAR, J.

October 6, 1936.

RE-ASSESSMENT—OMISSION TO ISSUE NOTICE UNDER SEC. 22 (2)—NO PREVIOUS ASSESSMENT AT ALL—POWER TO ASSESS UNDER SEC. 34—'ESCAPE ASSESSMENT', MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 22 (2), 34.

Section 34 of the Indian Income Tax Act (which empowers an Income Tax Officer to assess income which has escaped assessment) is wide enough to include cases where no notice under Sec. 22 (2) had been issued to the assessee and his income had not been assessed at all under Sec. 23.

[Observations Sir George Rankin in *Lachhiram Basantlal, In re* (58 Cal. 909) dissented from.]

Where an assessment starts with a notice under Sec. 34 all the relevant provisions of the Act apply as effectively as where the assessment starts with a notice under Sec. 22 (2).

Cases referred to :

COMMISSIONER OF INCOME TAX, BOMBAY *v.* G. V. MANOHAR [1935] (1935 I.T.R. 373; 59 Bom. 626; 37 Bom. L.R. 697; A.I.R. 1935 Bom. 410; 158 I.C. 757; 8 I.T.C. 273).

COMMISSIONER OF INCOME TAX, BURMA *v.* N. N. BURJORJEE [1931] (A.I.R. 1931 Rang. 101; 131 I.C. 507; I.L.R. 9 Rang. 161; 5 I.T C. 270).

LACHHIRAM BASANTLAL, *In re* [1931] (I.L.R. 58 Cal. 909; 133 I.C. 187; 35 C.W.N. 310; A.I.R. 1931 Cal. 545; 5 I.T.C. 114)

MADAN MOHAN LAL *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1935] (1935 I.T.R. 438; 16 Lah. 937; 158 I.C. 718; A.I.R. 1935 Lah. 742; 8 I.T.C. 413).

RAJENDRANATH MUKHERJEE *v.* COMMISSIONER OF INCOME TAX, BENGAL, [1934] (1934 I.T.R. 71; 61 Cal. 285; 114 7 I.C. 663; A.I.R. 1934 P.C. 30; 7 I.T.C. 143).

Case stated by the Commissioner of Income Tax, Bombay under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922). [Civil Ref. No. 5 of 1936].

Civil Ref. No. 5 of 1936, decided on 6th October, 1936 made by Commissioner of Income Tax, Bombay Presidency and Aden.

K. Mc. I. Kemp and *E. M. Eastly*, for the Commissioner.

Jamshed Kanga, for the Assessee.

JUDGMENT.

BEAUMONT, C. J.—This is a reference by the Commissioner of Income tax under S. 66 (2) of the Income Tax Act, XI of 1922, which raises a question within a narrow compass but of considerable importance in the administration of the law relating to income tax, and there appears to be no direct authority upon the point. The question is:

"Inasmuch as the income of the assessee for the year ending 31st March 1934 was not at all assessed in the year 1934-1935, was the Income tax Officer justified in taking action in the following year under S. 34 of the Act to assess the said income which had escaped assessment?"

In spite of the absence of authority, I do not feel any doubt as to how the question should be answered. The material facts are these. The year of assessment is the year ending 31st March 1935, and the previous year ended on 31st March 1934. No notice was served on the assessee under S. 22, sub-s. (2), during the year of assessment, but on 24th June 1935, a notice was served on the assessee under S. 34, alleging that her income for the year of assessment had escaped assessment. Under S. 3 of the Income tax Act, a tax is charged in respect of all income, profits or gains of the previous year of every individual. In S. 22 (2) it is provided that:

"In the case of any person other than a company whose total income is, in the Income tax Officer's opinion, of such an amount as to render such person liable to income tax the Income tax Officer shall serve a notice upon him requiring him to furnish, within such period, not being less than thirty days as may be specified in the notice, a return in the prescribed form and verified in the prescribed manner setting forth (along with such other particulars as may be provided for in the notice) his total income during the previous year."

So that in the case of an individual his liability to assessment starts with a notice from the Income tax Officer requiring him to make a return, and if he receives no notice, he is not liable to make a return. In this case the assessee received no notice during the year of assessment. Then we come to S. 34 which provides that:

"If for any reason income, profits or gains chargeable to income tax has escaped assessment in any year or has been assessed at too low a rate, the Income tax Officer may, at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains or in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-s. (2) of S. 22 and may proceed to assess or re-assess such income, profits or gains, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section."

There is no doubt in this case that the assessee had income, profits or gains chargeable to income tax, but it is said that the income, profits or gains had not escaped assessment within S. 34, because no assessment had ever been started and therefore there was no assessment to escape. Reliance is placed by the assessee on a dictum of SIR GEORGE RANKIN in *In re Lachhiram Basantlal.* There the learned Chief Justice said as follows, (p. 912 of 58 Cal.)

"Section 34 deals with income which has escaped assessment and it may be, though it is not necessary for the present purpose to decide it, that income cannot be said to have escaped assessment in the case where an assessment has been made which does not include the income. I do not proceed upon that footing because it is unnecessary for the purpose of the present case."

Reliance is also placed by the assessee on some observations of the Privy Council in *Rajendranath Mukerjee* v. *Commissioner of Income Tax* in which their Lordships held that the expression "has escaped assessment" in S. 34 is not equivalent to "has not been assessed" but their Lordships were dealing with a different point in that case, and later in their judgment they say this (p. 16 of 61 I.A.):

"It may be that if no notice calling for a return under S. 22 is issued within the tax year, then S. 34 provides the only means available to the Crown of remedying the omission, but that is a different matter."

So that the actual point which we have to deal with, was expressly left open by the Privy Council. With all respect to SIR GEORGE RANKIN, I do not think there is any force in the suggestion he made. It is quite true that the word 'escape' denotes that some risk has been avoided. If a man were to say that he spent a month in Bombay and escaped the plague, one would infer that there was an epidemic of plague, or, at any rate, some risk of

plague at the time, in Bombay, otherwise the use of the word 'escape' would be inappropriate; but under S. 34 what must be escaped is assessment and that means the whole process of assessment, which, in the case of individuals, starts with the service of a notice under S. 22 (2). The liability to assessment is a risk to which every person in British India entitled to income is liable, and I cannot see why the process of assessment has not been just as much escaped by a person who receives no notice under S. 22 (2) as by a person who receives such a notice which proves in fact ineffective. It seems to me that a person who receives no notice under S. 22 (2) has escaped assessment, although through no fault of his own, the process of assessment has never been set in motion.

It is argued by Sir Jamshedji Kanga on behalf of the assessee that the scheme of the Act is against applying S. 34 to a case in which no notice has been given under S. 22 (2). But I do not see the force of that argument, because S. 34 itself provides that the notice served under that section may contain all or any of the requirements which may be included in a notice under sub-S. (2) of S. 22, and then the assessment may proceed, and the provisions of the Act are to apply, so far as may be, as if the notice were a notice issued under that sub-section. In my opinion, where the assessment starts, as in this case, with a notice under S. 34, all the relevant provisions of the Act are to apply as effectively as where the assessment starts with a notice under S. 22 (2). In my opinion therefore the view of the Income Tax Commissioner is right, and the question submitted to us should be answered in the affirmative. The assessee to pay the costs less the amount of the deposit of Rs. 100. Costs to be taxed on the Original Side scale by the Taxing Master.

RANGNEKAR, J.—I agree. The question raised on this reference is not covered by any direct authority, and counsel therefore have, not unnaturally, relied upon the scheme of the Act and some judicial dicta in several cases in support of their respective contentions. Shortly put, the assessee's contention is that, having regard to the scheme of the Act, S. 34 is inapplicable when no notice at all has been issued to an individual under S. 22 (2) and consequently his total income not at all assessed under S. 23. He says that in that case the expression 'escape assessment' used under S. 34 cannot apply, and that the expression is only appropriate when an individual has been assessed in respect of his total income but for some reason or other part of the income charge-

the Privy Council. The learned counsel also relied on some observations made by me in *Commissioner of Income tax* v. *Gopal Vaijinath*. I do not think that I have said anything in that case which is contrary to the view which I am now taking on this reference. In that case we had to consider S. 34 with reference to the facts before us. The facts were that a person had already been assessed previously by one Income tax Officer. In the next year of assessment, another Income tax Officer thought the previous assessment was wrong and was made at a lower rate, and it was in that connection that the observations I made became necessary. On the other hand, the view which we are taking was also taken in *Commissioner of Income tax* v. *N. N. Burjorjee* and *Madan Mohan Lal* v. *Commissioner of Income tax, Punjab*. It is true that the facts in those cases were not similar to the facts before us: but I think the opinions expressed in those cases seem to me, with respect, to be correct. I agree therefore that the question should be answered in the way proposed by my Lord the Chief Justice.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

BANKE BIHARI LAL

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

COLDSTREAM and DIN MOHAMMAD, JJ.

April 28, 1937.

SALARY—DEFERRING DRAWING OF SALARY TO AVOID HIGHER RATE OF TAX—LEGALITY—DISBURSING OFFICER, WHETHER TRUSTEE OR BAILEE—SALARY, WHETHER ASSESSABLE UNTIL ACTUALLY RECEIVED—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 7, 18 (2), 60 (2)—CIVIL ACCOUNT CODE, ART. 70.

The assessee was an Assistant Superintendent in the office of the Auditor General. His monthly pay during the year of account 1934-35 was Rs. 427-8-0 and his pay for twelve months would accordingly have amounted to Rs. 5,130. He wrote to the head of his office to pay him his salary for February 1935 on the 1st of April instead of on the 1st of March so that his total income for 1934-35 may be less than Rs. 5,000 and the officer complied with his request. The income tax authorities included the February salary also in computing the total income of the assessee on the ground that it was drawn in March by the disbursing officer and must be regarded as having been paid to the assessee in that month as this amount must be treated as having been held by the head of the office in trust for the assessee until it was actually paid over to him. Held, *on a reference by the Commissioner, that there was no reason why the head of the office in such circumstances should be treated as a bailee or trustee; that income tax is to be assessed upon salary with reference to the time at which it is actually received by the employee and that the income tax authorities acted wrongly in including the February salary in computing the total assessable income of the assessee.*

Cases referred to:

BHIKHAMCHAND LAXMICHAND *v.* COMMISSIONER OF INCOME TAX, U.P. & C.P. [1935] (7 I.T.C. 184; 1935 I.T.R. 120).

COMMISSIONER OF INCOME TAX, BURMA *v.* BOMBAY BURMA TRADING CORPORATION [1933] (11 Rang. 172; 1933 I.T.R. 152).

Case stated by the Commissioner of Income Tax, Punjab, under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922, in the matter of the assessment of Banke Bihari Lal for the assessment year 1935-36.

Bhagawat Dayal, for the Assessee.

S. M. Sikri for *J. N. Aggarwal*, for the Commissioner.

JUDGMENT.

COLDSTREAM, J.—This is a reference made to this court by the Commissioner of Income Tax, Punjab, North West Frontier and Delhi Provinces, under Sec. 66 (2) of the Indian Income Tax Act of 1922 arising out of the assessment to Income Tax of a Government servant.

The circumstances stated by the Commissioner are as follows:

The assessee is an Assistant Superintendent in the office of the Auditor General. His monthly pay during 1934-35 (assessable for 1935-36 assessment) was Rs. 427-8-0. His pay for the twelve months would accordingly amount to Rs. 5,130 chargeable at 9 pies per rupee plus 25 per cent. If however his February pay, normally payable in March were deferred to 1935-36, his salary in 1934-35 would be taxable at the rate of 6 pies plus 25 per cent and the remaining Rs. 428 would be taxable at whatever rate was found appropriate to the 1936-37 assessment which in ordinary expectation would be 9 pies plus one-sixth. In May 1935 the assessee made a return including his salary for March 1934 (paid normally in April) to January 1935 accompanied by a letter submitted through the head of his office who noted on it that pay for February 1935 was 'disbursed to him' on 1st April 1935. Assessment was made originally on the basis of that return.

Meanwhile the Income Tax Officer, under instructions from the Commissioner, served notice on the assessee for inclusion of the salary for February. In his reply the assessee stated that in a letter dated the 5th February he had asked the head of the office to pay him his February salary on the 1st April instead of on 1st March 1935 and that the head of his office had complied with his request. The letter of the 5th February ran:

"I beg to request may pay for the month of February 1935 may kindly be paid to me on the 1st April 1935 instead of on 1st March, 1935. By doing so my total income for the financial year ending on 31st March 1935 will be less than Rs. 5,000 and I will be assessed to income-tax at the rate of 6 pies per rupee instead of 9 pies per rupee."

The assessee's salary was drawn by the head of his office either on the 21st or 27th March.

The Income Tax Officer included the salary for February in the year's assessment on the ground that as it was drawn in

March it must be regarded as having been paid in that month, because it was held by the head of the office in trust for the assessee until it was actually received by the latter.

The assessee appealed pointing out that under article 70 of the Civil Account Code the head of the office is responsible to Government for pay drawn by him until he has paid it to the person entitled to receive it and obtained his receipt, that in exactly similar circumstances salary for eleven months only had been assessed in previous years and that the action of the Income Tax Officer had overruled the decision of his predecessors.

The Assistant Commissioner rejected the appeal and the assessee asked for a reference to this Court.

The question referred by the Commissioner is "was it impossible as an issue of law for the Assistant Commissioner to find that the assessee's salary for February 1935 was paid by or on behalf of Government before the end of March 1935?" The Commissioner's opinion is that, as section 7 of the Indian Income Tax Act does not require salary which is taxable to be received by the assessee but paid by the employer within the period concerned, and, as it was the duty of the head of the office to disburse the salary with reasonable promptitude and return it to the Treasury if he could not disburse it, and as it was at the assessee's request that he retained it longer than was necessary, the head of the office can have retained it only as a bailee or agent for the assessee. In his opinion therefore payment was made when the money was drawn from the Treasury and the head of the office began to hold it as the assessee's agent.

I am unable to see why the head of the office in the circumstances of this case must be regarded as a bailee or trustee. The obligation to pay a certain sum of money to the assessee could not make him a bailee; for bailment can be of specific property only He was clearly not acting as the assessee's agent in drawing the salary for February for he had not been authorised by the assessee either to draw the February salary in March or to keep it on the assessee's behalf, and if the view taken by the Income Tax Authorities that the salary was in law paid when it was drawn be correct, he was acting in a manner prejudicial to the assessee.

That income tax is to be assessed upon salary with reference to the time at which it is actually received by the employee seems clear from the provisions of Sec. 18 (2) and Sec. 60 (2) of the Act. Sec. 18 (2) lays down that income tax is to be deducted at the time of payment and as no deduction was made in March

in this case it follows that the February salary was paid not in March but in April. Sec. 60 (2) clearly indicates that the assessment is to be on the amount actually received during the period for which the tax is assessed.

Rule 70 of the Civil Account Code makes it clear that the assessee's February salary did not under the rules belong to him in March for had the head of the office lost it the responsibility would have been his, no receipt for it having been given by the assessee.

Here I may say that we have not been referred to any law or rule making it obligatory for an employee to demand payment of his salary in the month following that for which it is payable or forbidding him to ask for its payment to be postponed.

In support of the Commissioner's view counsel for the Crown has cited *Bhikam Chand Laxmi Chand* v. *Commissioner of Income Tax, Central and United Provinces* (7 I.T.C. 184) but that judgment does not deal with the taxation of salaries for which Sec. 7 of the Act specially provides.

The Full Bench judgment of the Rangoon High Court in *Commissioner of Income Tax, Burmah* v. *Bombay Burmah Trading Corporation*, (I.L.R. 11 Rangoon 172) on which reliance is placed by counsel for the assessee dealt with a case relating not to the assessment of salaries but to the assessment of contributions by the employer to his employee's provident fund, but much of what is said in that judgment goes to support the present assessee. The opinion was there expressed that upon a true construction of Sec. 7 (1) read with Sec. 18 (2) salary is not assessable to income tax until it has been paid to and received by the employee, the scheme of the Act being to levy income tax not upon potential but actual profits.

Lastly it is to be noticed that the prescribed form for the return of income tax on salaries includes not the months of the income tax year for which salary is payable but the month March to February in which the salary is paid.

For the reasons I have indicated I would answer the question referred in the affirmative.

The assessee will have his costs and his deposit will be returned to him.

DIN MOHAMMAD, J.—I agree.

Question answered in the affirmative.

[IN THE CALCUTTA HIGH COURT.]

NORTH BRITISH AND MERCANTILE INSURANCE CO., *In re*

SIR HAROLD DERBYSHIRE, C. J., COSTELLO, J., and PANCKRIDGE, J.

March 20, 1937.

INCOME TAX—INSURANCE COMPANY—PROFITS ASCERTAINED UNDER RULES 25 AND 35—COMPANY'S RIGHT TO CLAIM DEDUCTION OF INTEREST ON TAX FREE SECURITIES FROM PROFITS SO ASCERTAINED—RIGHT TO CLAIM CREDIT FOR INCOME TAX ON INTEREST ON SECURITIES DEDUCTED AT SOURCE—REFERENCE—MODE OF FRAMING QUESTIONS—CONFLICT BETWEEN ACT AND RULES—ACT MUST PREVAIL—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 8, 18—INCOME TAX RULES, RR. 25, 35.

Per DERBYSHIRE, C.J., COSTELLO, J., and PANCKRIDGE, J.—*Where income tax is charged in respect of the income, profits and gains of a life insurance company computed in the manner prescribed by Rules 25 and 35 of the Rules framed under Sec. 59 of the Indian Income Tax Act, the company can claim credit under Sec. 18 (5) of the said Act for any deductions of tax on interest on securities made at source.*

Per DERBYSHIRE, C.J., and COSTELLO, J. (PANCKRIDGE, J., dissenting:—*Where the profits of a life insurance company have been ascertained under Rules 25 and 35 of the Rules framed under Sec. 59 of the Indian Income Tax Act, the company is entitled to claim that from the amount so ascertained so much of the income, profits and gains of the company as are due to interest on tax free securities of the Government of India should be deducted in computing its assessable income.*

Where there is a conflict between Rules framed under a statute and the enactment of the Statute itself, the enactment must be treated as the governing consideration and the rules as subordinate to it even though the rules may have statutory authority.

A privilege or exemption ought always to be taken into account, whether assessment is made under one part of a taxing statute or another part of the same Act.

PANCKRIDGE, J.—*The notional figure arrived at under Rules 25 and 35 of the Income Tax Rules cannot be analysed or dissected so as to allow the proviso to Sec. 8 to operate.*

The 'previous year' in the case of insurance companies means the twelve months ending with the last day of the year last preceding the beginning of the year of charge.

Because a question is a question of law it is not necessary to state in a general form and it is often preferable to formulate it with reference to the facts of the particular case.

When what is appealed against is an assessment or re-assessment under Sec. 34, the Assistant Commissioner is bound to confine himself to what is covered by such assessment or re-assessment and cannot deal with the matter covered by the previous assessment under Sec. 23. In any event he has no power to enhance the assessment when the assessee rightly objects to the assessment or re-assessment on the ground that the proceedings of the Income Tax Officer were without jurisdiction on the face of them.

Cases referred to:

HUGHES *v.* BANK OF NEW ZEALAND [1936] (53 T.L.R. 258 3 All E. R. 975).

INSTITUTE OF PATENT AGENTS *v.* LOCKWOOD [1894] (1894 A. C. 347).

KASHINATH BAGLA *v.* COMMISSIONER OF INCOME TAX, U. P. [1931] (4 I.T.C. 472; 136 I.C. 575; A.I.R. 1932 A. 1).

MINISTER OF HEALTH *v.* THE KING [1931] (1931 A. C. 494).

QUEEN *v.* BIRD & OTHERS. [1898] (Q. B. 340).

SATYENDRAMOHAN ROY CHOUDHRY, *In re.* [1930] (34 C.W.N. 816; I.L.R. 58 Cal. 326; A.I.R. 1930 Cal. 627; 129 I.C. 405; 4 I.T.C. 447).

Case stated by the Commissioner of Income Tax, Bengal, under Sec. 66 (2) of the Indian Income Tax Act, in the matter of the assessment of the North British and Mercantile Insurance Co.

STATEMENT OF CASE.

At the request of the North British and Mercantile Insurance Company Limited (hereinafter referred to as the assessee) a Statement of Case is submitted for the decision of Their Lordships under Sec. 66 (2) of the Indian Income Tax Act on the questions of law which will be found formulated in paragraphs 9 and 12 of this statement.

2. **Facts of the Case.**—The assessee, which is an insurance company incorporated in England, has asked for a reference in respect of questions arising out of the assessments for the years 1932-33, 1933-34 and 1934-35. The point at issue in respect of the assessments for the last two years are identical, but in addition the assessee has formulated two further questions in respect of the assessment for 1932-33 and in these two questions, the legality of the Income-tax Officer's action in starting and making a supplementary assessment under Section 34 of the Act and the legality of the Assistant Commissioner's action in enhancing the assessment when the case came before him on appeal have been questioned. I propose to state a case for the assessment year 1934-35 in respect of the questions which are common to the three assessment years and decide the questions at issue so far as they relate to the assessment years 1932-33 and 1933-34 in accordance with Their Lordships' decision on this reference: while as regards the two additional questions in respect of the assessment year 1932-33, I am stating a case herein on one of them for Their Lordships' decision.

3. This Company does business in Life Insurance and Fire Insurance in India as well as in other parts of the world and the assessment for the year 1934-35 was made on an income of Rs. 6,90,883 of which Rs. 5,24,967 is from Life Assurance business and Rs. 1,65,916 from Fire Assurance business. There is no objection regarding the income from the latter and I shall therefore confine myself to the Life Assurance business in this statement.

4. In accordance with Sec. 59 (2) (a) of the Income Tax Act the Central Board of Revenue may make rules prescribing the manner in which, and the procedure by which the income, profits and gains shall be arrived at in the case of insurance companies. According to Clause (5) of Sec. 59, rules made under this section shall have effect as if enacted in this Act. The Central Board of Revenue have framed Rules and the Rules, so far as they are relevant to this case, are Rules 25, 27, 30 and 35. In accordance

with Rule 35, the total income of the Indian branches of non-resident insurance companies (Life, Marine, Fire, etc)., in the absence of more reliable data, may be deemed to be the proportion of the total income, profits or gains of the companies, corresponding to the proportion which their Indian premium income bears to their total premium income and for the purpose of this Rule, the total income, profits or gains of non-resident Life Assurance Companies whose profits are periodically ascertained by actuarial valuation shall be computed in the same manner as is prescribed in Rule 25 for the computation of income, profits and gains of Life Assurance Companies incorporated in British India.

Rule 25 reads as below :—

"In the case of Life Assurance Companies incorporated in British India whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the Life Assurance Business shall be the average annual net profits disclosed by the last preceding valuation, provided that any deductions made from the gross income in arriving at the actuarial valuation which are not admissible for the purpose of income-tax assessment, and any Indian income-tax deducted from or paid on income derived from investments before such income is received, shall be added to the net profits disclosed by the valuation".

The computation of profits in the case under discussion has been made in accordance with Rule 35 read with Rule 25. The average annual net profit disclosed by the last preceding actuarial valuation which has been made the basis of the assessment under discussion is of the quinquennial period ending 31st December, 1930. The accounting period in respect of the assessment year 1934-35 is the year ended 31st December, 1933. The average annual profit the quinquennial valuation period ended 31st December, 1930, has according to the provisions of Rule 25 been taken to be the income of the "previous year."

5. The company did not submit their all world account to the Income-tax Officer but a statement of accounts of Life Business in India (including Burma) was submitted. The Income-tax Officer however in making his assessment went on this statement which reads as below .

LIFE BUSINESS IN INDIA (including Burma).

The profit or loss on the Life Business cannot be ascertained by simply taking the difference between the income on the one

hand and the outgo on the other. It can only be ascertained by actuarial calculation in which the whole amount of the interest received is taken into account.

Valuations were made as at 31st December, 1925, and 31st December, 1930, and the profit for the 5 years 1926 to 1930 inclusive, including the interest received, amounted to Rs. 26,24,835, of which one-fifth is applicable to the year 1933.

	Rs. 5,24,967-0-0
Less expenses in 1933 in collection of interest ...	1,520-4-0

The sum of Rs. 1,520-4-0 relates to interest received in the year ended 31st December, 1933, and does not concern the valuation period ended 31st December, 1930.

TOTAL INTEREST RECEIVED—

(1) Interest on Investments on which tax has already been paid—

(*a*) Interest taxed at source Gross ... Rs. 6,90,921-4-0
Tax 1,16,953-1-6.

(*b*) Interest received free of Tax equals net 22,100-0-0

(2) "Interest from which Tax has not been deducted—

(*a*) Interest on loans granted by the Company on security of its policies ... 1,56,528-12-0.

(*b*) Interest on Bank Deposits 1,098-7-0

1,57,627-3-0

8,70,648-7-0"

The Income-tax Officer asked the company to produce a certificate as to the composition of the interest item entering into the profit on life Business for the quinquennium 1926-30 in response to which the following statement signed by the London Actuary of the Company, dated 15th June 1934 was submitted.

"INDIAN INCOME TAX—

Life Profits 1926-30—Indian Business.

Liability 1st January 1926 including new bonus	1,93,31,960
Premiums ...	1,21,93,333
Interest ...	48,08,196
	3,63,33,489

Claims	... 76,52,860
Surrenders and Bonus Surrenders	... 12,20,285
Commission and Expenses of Management	... 27,43,500
Liability 31st December 1930	... 2,20,92,009
Profit for Quinquennium	... 26,24,835
	3,63,33,489

Yearly profit for purposes of Indian Taxation 1931-32 to 1935-36, one fifth of Rs. 26,24,835 ... 5,24,967

"The interest collected in India during the quinquennium 1926-1930 on our Indian Life Investments amounted to Rs. 40,75,708 as will be seen from the accompanying statement A."

"The amount of interest considered to have been earned on the Indian Life business, however, during the same period, calculated at the average rate earned on the total Life funds of the Company, amounted to Rs. 48,08,196 and in computing the Indian Life Profits of 1926-30 for the purposes of the valuation of our Indian Life business, an amount of Rs. 7,32,488 has been added to the amount of the interest Rs. 40,75,708 collected in India in order to arrive at the figure of Rs. 48,08,196 credited in the valuation statement."

The statement marked "A" referred to above is subjoined.

"A"

NORTH BRITISH & MERCANTILE INSURANCE COMPANY LIMITED.

Interest collected in India on Indian Life Investments.

Year	Taxed at source in India (Gross interest)	Free of Indian Income Tax	Without deduction of Indian Tax
	Rs.	Rs.	Rs.
1926	4,44,692	2,04,790	88,195
1927	4,49,834	2,04,790	98,031
1928	4,97,074	2,04,790	99,713
1929	5,32,093	1,95,911	1,08,421
1930	7,90,060	22,577	1,34,767
	27,13,723	8,32,858	5,29,127

Deposits, etc.

SUMMARY FOR QUINQUENNIUM 1926-1930.

		Rs.
Taxed at source in India (Gross Interest)	...	27,13,723
Free of Indian Income Tax	...	8,32,858
Without deduction of Indian Tax	...	5,29,127
Total Interest collected in India on Indian Investments	..	40,75,708

6. In making the assessment, the Income-tax Officer took the Life Assurance business income to be Rs. 5,24,967 as returned by the company but he classified it under the following heads—

Business loss	...	Rs.	18,433		
Interest on securities—					
Taxed	...	Rs.	5,42,744		
Tax-free	...	Rs.	1,66,572	...	7,09,316
					6,90,883

The income from Fire Assurance business being Rs. 1,65,916 the balance Rs. 5,24,967 relates to the Life Assurance business. The amounts of interest on Indian securities received by the Company during the five years ending 31st December, 1930, for which the last actuarial valuation was made are as below. (There is no dispute about these figures.)

Year.		Gross interest.	Tax		
		Rs.	Rs.	A.	P.
1926	...	4,46,692	41,689	15	2
1927	...	4,49,834	42,172	1	3
1928	...	4,97,074	46,608	9	4
1929	...	5,32,063	49,877	1	3
1930	...	7,90,060	76,314	2	8
		27,13,723	2,59,661	13	8
	Average	5,42,744	51,332	6	0

Purporting to act under provisions of Rule 27 of the Rules under the Income-Tax Act, the Income-tax Officer gave credit

of Rs. 51,322-6-0 in the assessment which worked out as below—

Fire Profit ...	Rs.	1,65,916
One-fifth of life profits as per valuation as on 31st December 1930 as settled. ...	Rs.	5,24,967
Total income ...	Rs.	6,90,883
Less Interest on tax free securities being one-fifth of same as included in the above surplus ...	Rs.	1,66,572
Interest on taxed securities as above ... Rs. 5,42,744 ...	Rs.	7,09,316
Business Loss ...	Rs.	18,433
Less interest on taxed securities...	Rs.	5,42,744
Taxable income ...	Rs.	5,24,311
Add tax-free interest ...	Rs.	1,66,572
Total income ...	Rs.	6,90,883

	Rs.	A	P
Income-tax on Rs. 5,24,311 at 26 pies per rupee ...	71,000	7	0
Less credit under Sec. 18(5) being one fifth tax deducted as already worked out ...	51,332	6	0
	19,668	1	0
Surcharged 25 per cent ...	17,750	2	0
	37,418	3	0

SUPER-TAX.

Total income ...	6,90,883
Less ...	50,000
	6,40,880

	Rs.	A.	P.
Super-tax thereon at 12 pies per rupee	40,055	3	0
Surcharge 25 per cent ...	10,013	13	0
	50,069	0	0

It will be seen that the Income-tax Officer here classified the average of the actuarial surplus, although according to rule 25, the average annual net profits disclosed by the actuarial valuation are to be held as income, profits and gains of the Life Assurance Business and according to rule 35, these average profits will be the basis of the determination of notional total income. In making this classification and saying that he gave credit under Sec. 18 (5) he accepted the statement of the assessee without examination and proof and in this he was clearly wrong. The credit was really given in accordance with Rule 27 of the Rules framed under the Act.

7. The Company appealed to the Assistant Commissioner and relevant extracts from the grounds of appeal are subjoined.

"5. Your Petitioner had, however, in point of fact already paid income tax in the year ending 31st December 1933 amounting to Rs. 1,16,953-1-6, by deductions at source from interest on securities under Section 18 of the said Act.

"6. Notwithstanding this, however, the Income-tax Officer in contravention and in disregard of the express provisions of Sec. 18 (5) of the said Act failed to give your Petitioner credit for the said sum of Rs. 1,16,953-1-6 in the said assessment under appeal, being the assessment for the following year within the meaning of the said Section. The Income-tax Officer only gave your Petitioner credit for a sum of Rs. 51,332-6-0. In the result your Petitioner has suffered double taxation to the extent of the difference, *viz.*, Rs. 65,620-11-6.

"7. Your Petitioner contends and submits that Sec. 18 (5) of the said Act is clear and unambiguous in its meaning and is mandatory. The provisions of the said section cannot be varied or modified by rules or directions introduced by the Income-tax Manual or otherwise and your Petitioner is entitled as of statutory right to the full credit in the assessment under appeal for the whole amount of income-tax paid as aforesaid by deduction during the year ending 31st December 1933.

"8. If such credit had been given by the Income-tax Officer your Petitioner would have been entitled to a refund of Rs. 28,202-8-6 instead of which a demand has been made on your Petitioner to pay a further sum in tax of Rs. 37,418-3 0.

"9. Your Petitioner claims that the assessment be reduced by giving the full credit of tax previously paid in conformity with the provisions of Section 18 (5) of the said Act and your Petitioner claims a refund accordingly."

The complaint of the assessee before the Assistant Commissioner of Income-tax was that they should have been given credit for a sum of Rs. 1,16,953-1-3 under Sec. 18 (5) while the Income-tax Officer had allowed a credit of Rs. 51,332-6-0 purporting to act under Rule 27. In disposing of the appeal under Sec. 31 (3) (*a*), the Assistant Commissioner of Income-tax enhanced the assessment (after giving the appellant a reasonable opportunity of showing cause) by holding that the income assessed although shown by the Income-tax Officer as classified into the heads stated above is in fact Life Assurance Business income not capable of such classification. A copy of the Assistant Commissioner's appeal order is in Appendix "C".

8. In their application under Sec. 66 (2) the Assessee Company formulated three questions as arising out of the appellate order. As I do not propose to refer any of those questions as formulated by the assessee, they need not be reproduced here. These questions, however, will be found in Appendix "D".

The questions of law that really arise out of the appellate order may be formulated as below:

Question 1:—Whether, when the income, profits and gains of a Life Assurance Company are arrived at for the purpose of charging income-tax for any year, in the manner prescribed by Rule 35 read with Rule 25 of the rules made by the Central Board of Revenue in exercise of the powers conferred by Section 59 of the Indian Income-tax Act (Act XI of 1922) it is open to the assessee to go behind this notional figure by referring to the actual sources of its receipts and claim exemption from taxation in respect of any portion of the income.

Question 2:—Whether, when the income, profits and gains of a Life Assurance Company are arrived at for the purpose and in the manner specified in question 1, and income-tax is charged in respect of such amount, it is open to the assessee to go behind this notional figure and refer to the actual sources of its receipts in order to claim that a portion of the total income

calculated represented income chargeable under the head "interest on securities".

Question 3:—Whether, when income-tax for any year is charged in respect of income, profits and gains of a Life Insurance Company computed in the manner prescribed by the rules referred to in question 1, the assessee can claim credit under Sec. 18 (5) of the Indian Income-tax Act, for any deductions of tax made at the sources.

Instead of referring the questions as framed by the assessee I beg to refer the above three questions to the Hon'ble High Court and as required by Sec. 66 (2) of the Indian Income-tax Act I give below my own opinion thereon.

10. In my opinion when for the purposes of assessment of Insurance Company its income, profits or gains are determined in the manner prescribed by the Rules 25 to 35, it is not open to us to analyse the figure thus arrived at and determine the several elements constituting the total. It is indeed difficult thus to analyse the figure arrived at by the empirical method prescribed by the rules. The question of determining the profit and loss of an Insurance Company is very complex and it was with a view to avoid all such complex calculations involved in the matter, that certain empirical rules were framed for the assessment purposes. Whatever may be the reason why these empirical rules were so framed, we have given those rules and we are bound to apply them and them only for the purpose of finding out the total income of an Insurance Company. For such a Company therfore the total income becomes only a notional income and unless otherwise provided by these rules it is not open to us to introduce any dissection or analysis of this total. In my opinion in the case of an Insuranc Company, its income, profits and gains are not even classified under the heads referred to in Sec. 6 for determining the manner in which these are to be charged to income-tax. Such manner of its chargeability is otherwise provided by the Act. Assessment of such a company is specially provided for by these rules and it is to be remembered that Sec. 59 (5) makes them as effective as if enacted in the Act. Sec. 3 of the Income-Tax Act, generally known as the charging section, provides that while charging income-tax for any year, it shall be charged in respect of all income, profits and gains of the previous year of the assessee. Sec. 2 (11) (*b*) defines the 'previous year' in the case of a company or class of company to be 'such period as may be determined by the Central Board of Revenue or by such authority as the Board

may authorise in this behalf'. Section 22 (1) requires that every company shall furnish a return of the 'total income' of the Company during the previous year and Section 23 (1) provides for assessment of this 'total income'. It may be pointed out that 'the previous year' does not necessarily mean the preceding year. It may be any other period, and the Central Board of Revenue is given power to determine such a period. Whatever be the period that may be determined to be the previous year for a Company, it must be remembered that assessment for any year does not mean assessment in respect of the income of that year, but assessment in respect of the income of 'the previous year'. Consequently, if for example, 1930 be determined to be the previous year of a Company for its assessment for 1934-35, the income which will have to be found out must be the income of the year 1930 and it is this income which will be assessed during 1934-35. This will no doubt be arrear assessment. Indeed the scheme of the present Income-tax Act is one of arrear assessment. Only ordinarily the year's income is assessed during the next succeeding year. Ordinarily this is so. But this is not the general rule for all cases and it has already been pointed out how in cases of Companies it is open to the Board to determine otherwise. In the case of an Insurance Company Rules 25 to 35 determine this 'previous year' to be the average year of the preceding valuation period and Rule 35 gives the special rule for computation of 'total income' in case of a foreign insurance company. These rules it has been pointed out, have been made in the exercise of power conferred by Section 59. Section 59 empowers the Board to make rules for carrying out the purposes of this Act and for ascertainment and determination of any class of income. In particular the Section empowers the Board by making rules to prescribe the manner in which, and the procedure by which the income, profits and gains shall be arrived at in the case of Insurance Companies. "The income, profits and gains" here, in my opinion, means 'the income, profits and gains' in respect of which income-tax is to be charged under Section 3. In exercise of this power conferred by Section 59 the Board has made several rules, of which rules 25 to 30, 32 and 35 relate to the Insurance Companies. The one relevant for our present purpose is Rule 35 which prescribes the manner in which the total income of the assessee company is to be determined. The assessee itself while submitting its return worked up the proportion referred to in the rule and the Income-tax Officer simply accepted this calculation of the assessee. The

calculation made by the assessee for the purpose of this rule has already been given. It will appear therefrom that for the purpose of finding out the total income, profits and gains of the Company taken in all its branches, the assessee took the figures for the period of 5 years ending 31st December, 1930. Thus, the total income calculated for the Indian branch was really the average annual income of the branch during the period of 5 years ending 31st December, 1930. This is the income in respect of which income-tax has been charged for the year 1934-35. Remembering that the Central Board of Revenue cannot only prescribe the manner in which income to be charged shall have to be calculated, but can also determine which year's income shall be charged during which year, it seems obvious that by sanctioning the above method of determining the income to be charged for the year 1934-35, 'the previous year' for an Insurance Company within the meaning of Section 3 becomes not the preceding year but a year of the preceding valuation period. If this view be correct then the average year of this valuation period becomes the only relevant year for the purpose of assessment for any year till the next valuation. To my mind this seems to be quite reasonable also. Ascertainment of income, profits and gains of an Insurance Company is always a difficult matter. Where, therefore, there has been ascertainment of its profits by experts, the assessment may reasonably be directed to proceed on this expert calculation. Income of the valuation period is charged to income-tax by spreading it over another equally long period succeeding the valuation period. This makes the assessment quite reasonable and equitable. Otherwise if we take the previous year for an Insurance Company thus assessed to be the preceding year then for the assessment for 1934-35 we are to make assessment in respect of the income of the year ended 31st December 1933. But in determining this income the rules take us to the average annual income of the periods of 5 years ending 31st December 1930 and 31st December 1931. This will really be taking the average annual income of the valuation period to be the income assessable in 1934-35. Or in other words while Section 3 requires that assessment must be in respect of income of the previous year, these rules while professing only to prescribe the manner of computation of the income will, as a matter of fact, require us to make assessment in respect of income of a different year. To my mind such an interpretation of the rules will render them '*ultra vires*' of the powers conferred upon the Board by Sec. 59. I would therefore respectfully submit that these rules not only

prescribe the manner of computation of the income but also determine 'the previous year' for an Insurance Company. As regards the determination of the assessable income the rule is empirical and helps us to arrive only at a 'notional figure' not necessarily the actual figure of any particular year. In my opinion this figure does not refer to any particular source or sources as contemplated by S. 6 of the Act and does not admit of any dissection or analysis. The figure thus determined cannot be said to comprise income under one head or other as classified under Section 6. It is an empirically determined figure and represents only the total assessable income of the insurance company for its assessment for 1934-35. This figure of actuarial net profits is an item by itself and it has been directed in Rule 25 that this will be held to be Life Assurance business income. In this connection I would refer to the decision of the Lahore High Court in the case of the Lakshmi Insurance Company (V I.T.C. 24). It has been held in that case that Rule 25 of the rules made by the Central Board of Revenue under Section 59 (2) (a) is of a mandatory character and that it provides the only manner in which the income, profits and gains of Life Insurance Companies can be determined. It does not give any discretion to the assessing officer to depart from its provisions and to have recourse to the other provisions of the Income-tax Act for the purpose of determining and assessing the income, profits and gains of a Life Insurance Company. Sec. 10 of the Income-tax Act which provides for computation of business income (other than of Insurance Companies) will not therefore apply. These rules are intended to be self-contained provisions for assessment of insurance companies and to a case where these rules will apply the provisions contained in Secs. 6 to 12 shall have no application. That this is the intention of the law will be evident from Rule 30 which provides for allowing depreciation on assets (otherwise allowable under Sec. 10) and losses which are not ordinarily allowed. Again, in Rule 25, there is provision for adding to the average annual net profits, the tax deducted from investments of the company during the valuation period. If the other provisions of the Act applied, this provision in Rule 25 would be redundant, for according to Sec. 18 (4) of the Act, the tax deducted at source is to be deemed to be income received. If the average annual net profits could be held as containing income from taxed securities the provisions of Section 18 (4) would have been applicable to that portion of the income. It is because it is Life Assurance business income and not income from interest on securities or

from dividends as one of its components that it has been necessary to make provisions for giving credit of income-tax deducted from interest on the investment of a company doing life assurance business. This has been provided for in Rule 27. No part of the total income calculated in the manner provided by these rules can be said to represent any receipt by the Company which might not have been liable to pay tax. The amount thus determined must be taken to be the amount in respect of the whole of which income-tax is chargeable. In my opinion therefore both questions 1 and 2 should be answered in the negative.

11. As regards the third question I beg to submit that Sec. 18 (5) of the Income-tax Act has no application to a case where the assessment is not made per different heads of income as specified in Section 6. It has already been pointed out how in making assessments of an insurance company its assessable income is determined quite empirically and how the figure thus determined is taken as the 'total income' of the Company without any reference to the amount and sources of the receipt. Section 18, in my opinion, has no application to a case like that. This section applies only when an assessee is chargeable in respect of income under the heads 'salaries' and 'interests on securities'. In the case of the assessee Company there has been no assessment in respect of any such income. It has been assessed only in respect of a notional sum and it is not open to us to go behind this determined amount and examine the details of the calculation in order to discover which elements entered into this empirical calculation. In my opinion therefore this question should also be answered in the negative. It may be noticed here that in the above view of Section 18 (5) the allowance, even of the average deduction made by the Income-tax Officer may be held to be untenable. Reference, however, may be made to Rule 27 in this connection which seems amply to support the allowance made by the Income tax Officer. The rule says that if the Indian Income tax deducted from interest on the investments of a company exceeds the tax on the income, profits and gains thus calculated, a refund may be permitted of the amount by which the deduction from interest on investments exceeds the tax payable on such income, profits or gains. The rule does not explicitly speak of allowing credit for such deductions and does not state the period during which the deductions referred to have been made. Sec. 18 (5) provides that when certain deductions at the sources are made credit for the same must be given in the assessment made for the following year.

Rules 27 says nothing about which year's deductions are to be credited against which year's income tax As, however, these rules are contemplating the valuation, and as the expression "income, profits and gains thus calculated", refers to the period of valuation and refers to the annual average of that period's income, it is fair to take the 'deductions' also as referring to that period, and in the absence of any clear provision such deduction to be credited against annual average income should also be taken as annual average deduction. If this be correct, this is another reason why Section 18 (5) should not apply to these cases. For in that case credit for deductions made at sources during the valuation period shall have to be given under Rule 27 and then deductions made during the preceding year also shall have to be credited under Section 18 (5) and this last item will again have to be credited during the next quinquennial period.

12. I now set out the circumstances which have given rise to the two additional questions formulated by the assessee in connection with the assessment for the year 1932-33 referred to in Paragraph 2. For that year the Income tax Officer has computed the income in the following manner and the order of assessment is dated 20th March 1933.

			Rs.
Profit on Fire business.	...		2,09,544
Profit on business transacted in the name of the Insurance Office of Australasia Limited.	...		32,952
1-5th of Life profits as disclosed by the actuarial valuation of 31st December 1930.	...		5,24,967
			7,67,463
Less 1-5th of the interest on securities received during the quinquennium ended 31st December 1930 (included in the average annual profit) B.F....			7,67,463
		Rs.	
Taxed	...	5,42,744	
Tax-free	...	1,66,572	7,09,316
			58,147

Income-tax at 26 pies.	...	7,874-1-0
Surcharge 25 per cent.	...	1,968-8-0
		9,842-9-0

SUPER-TAX.

Total income	...	7,67,463
Less free	...	50,000
		7,17,463

Supertax at 12 pies	...	44,841-7-0
Surcharge 25 per cent	...	11,210-6-0
		56,051-13-0

It will be seen that tax was charged on Rs. 58,847, *i.e.*, after deducting income from interest on securities taxed and tax free. The effect of this was that the income from securities was taxed at the rates prevailing at the time of deduction at source. These rates were lower than the rate for the year of assessment. The Income-tax Officer therefore on the 17th August, 1933, issued a notice under Section 34 of the Act on the assessee which runs as follows:

"Whereas I have reason to believe that your income from interest on securities which has been assessed in the financial year ending 31st March, 1933, has been assessed at too low a rate and I therefore propose to re-assess your said income at the correct rate, I hereby require you to deliver to me not later than 16th September, 1933, or within 30 days of the receipt of this notice a return in the attached form of your income from all sources which were assessable in the said year ending 31st March 1933."

The assessee thereupon submitted a return of income the figure returned being the same as in the previous return. The income-tax Officer then proceeded to make a fresh calculation in the following manner;

Profit on Fire business and Life as already worked out	...	Rs. 7,67,463
Less interest on tax-free securities as before	... 1,66,572	
Taxed	... 5,42,744	7,09,316
		58,147
Add interest on securities	...	5,42,744
Taxable income	...	6,00,891
Tax-free interest	...	1,66,572
Total income	...	7,67,463

			Rs.	
Income-tax on Rs. 6,00,891 at 26 pies		...	81,370	10
Less income-tax already paid	... 7,874	1		
Credit under Sec. 18 (5)	... 51,332	6 ...	59,206	7
			22,164	3
Surcharge already paid	... 20,342	10		
Less surcharge paid	... 1,268	8 ...	18,374	2
			43,538	5

SUPER-TAX.

Total income	...	7,67,463	
Less	...	50,000	
		7,17,463	
Super-tax thereon at 12 pies per rupee	...	44,841	7
Surcharge 25 per cent	...	11,210	6
		56,051	13
Less super-tax and surcharge paid	...	56,051	13

Revised under Secs. 34 and 23 (1) for 1932-33 on Rs. 7,67,463 and income-tax and surcharge demanded amounts to Rs. 40,538-5. The super-tax demand is the same.

In this assessment the amount of taxed securities suffered income-tax at the rate for the year of assessment which was 32½ pies including surcharge. The credit given of Rs. 787-1-0 as shown above is the amount of income-tax paid under the original assessment and the sum of Rs. 51,332-6-0 is the average of the deductions at source in the actuarial quinquennium ended 31st December, 1930. In the original assessment the Income-tax Officer classified the income in the assessment form as below :—

		Rs.
Business	...	58,147
Interest on securities	...	7,09,316
		7,67,463

In the assessment under Sec. 34, the assessment form showed the following classification :—

		Rs.
Business	...	58,147
Interest on securities taxed	...	5,42,744
Tax free	...	1,66,572
		7,67,463

When the case came on appeal before the Assistant Commissioner of Income-tax that authority being of opinion that the Income-tax Officer had wrongly computed the assessee's income and tax by classifying the income under different heads as stated above instead of showing the entire income under "Business" as required by Rule 25, issued a notice on the assessee calling on him to show cause why the assessment should not be enhanced by treating entire income as Business income and on hearing the assessee-appellant, the Assistant Commissioner of Income tax proceeded to enhance the assessment treating the whole of this income as business income directing that this should be taxed accordingly.

The questions of law formulated by the assessee are as follows:—

(1) Whether upon the facts of this case and having regard to the form of the said notice under Sec. 34, the Income-tax Officer has jurisdiction to reopen your petitioner's assessment under the provisions of Sec. 34 of the Indian Income-tax Act, 1922, or to reassess in such manner as above mentioned.

(2) Whether in any event the Assistant Commissioner of Income-tax had jurisdiction to enhance the said assessment, having regard to the terms of the said notice under Sec. 34 and the general provisions of Indian Income-tax Act, 1922.

13. As regards the first question, the law is clear and I do not think that I should trouble Their Lordships by stating a case on it but as the second question is co-related with the first and it would be difficult for Their Lordships to appreciate the matter at issue on which the second question is based unless I set forth the circumstances which have given rise to the first question also, I respectfully venture to do so and also to state the grounds on which I am unwilling to state a case on the first question raised though such grounds should normally not find place in this statement.

I made a full note of the arguments advanced by the assessee's representative at the time of hearing of this application under Sec. 66 (2), but in those notes I can find no argument in support of the assessee's contention that the Income-tax Officer's action under Sec. 34 was without jurisdiction and in my respectful opinion it was not.

The question in what circumstances an Income-tax Officer can proceed under Sec. 34, has been discussed and decided on a number of occasions in the different High Courts in India and the matter has been before Their Lordships the Judges of the Calcutta High Court in the case of *Anglo Persian Oil Company* (I. L. R. 60 Cal. 84, 37 C. W. N. 430 (435), 6 I. T. C. 419 at page 426) and there RANKIN, C. J, observed as follows:—

"I see no way of holding that Sec. 34 is inapplicable to put right an assessment by which a deduction has been improperly allowed. Such a case is in my opinion a case of income escaping assessment—not the whole income of the assessee but a part of it escaping assessment, and there is nothing in Sec. 34 which limits it to cases of non-disclosure by the assessee or discovery of new matter by the Income-tax authorities or inadvertence as distinguished from erroneous deliberations on the part of these

authorities. We have been referred to the Madras decision in *Raja of Parlakimidi* v. *Commissioner of Income-tax, Madras* (2 I.T.C. 104) from which I see no reason to differ and to the English case of *Anderton and Halstead* v. *Birrell* (16 T.C. 200; (1932) 1. K.B. 271) which does not seem to afford any assistance upon the construction of the Indian Act."

The same view was taken by the Lahore High Court in the case of *Messrs. Amir Singh Sher Singh* v. *Commissioner of Income-tax, Punjab*, decided on the 26th February 1935, (1935) Lah. 361. Further in the English case of *Williams* v. *Trustees of W. W. Grundy*, (1934), 1 K.B. 524, it was held that where a previous Inspector of Taxes had considered a certain sum as not liable to tax, but his successor in a subsequent year arrived at a different conclusion and proceeded to raise tax on this sum, the change of opinion by the succeeding Inspector amounted in fact to a discovery by the Inspector that an item chargeable to income-tax has been omitted within the meaning of Sec. 125 of the Act.

It is perhaps not necessary to quote other rulings of the Indian Courts, bearing on this point, except the Full Bench ruling of the Lahore High Court in the case of *Madan Mohan Lal* v. *The Commissioner of Income-tax, Punjab* (1935) Lah. 742, decided on the 22nd July, 1935 where all previous rulings are discussed.

14. For the reasons stated above, I do not state a case on the first of the two questions mentioned above.

15. The second question set out in paragraph 12 above is respectfully submitted for the Court's decision. With regard to this question I would respectfully submit that under Sec. 31 of the Act, the Assistant Commissioner of Income-tax may in disposing of an appeal confirm, reduce, enhance or annul the assessment provided that he shall not enhance an assessment unless the appellant has had a reasonable opportunity of showing cause against such enhancement. No time limit within which the Assistant Commissioner of Income-tax may enhance an assessment is fixed in the Act, nor are the circumstances in which he may enhance laid down anywhere in the Act and I do not think any argument is to be drawn from the analogy of Sec. 34 of the Act which lays down

that the Income-tax Officer can initiate action for the taxation of income which had escaped assessment or the taxation at a correct rate of income which has been assessed at too low a rate only within a certain period, nor, I think, can the assessee argue that in this case if the Assistant Commissioner had not taken action for enhancement, the Income-tax Officer could not have done so by reason of the limitation imposed by Sec. 34 and therefore he is unfairly penalised for another course was open to the Assistant Commissioner in this case and he could have, if he had so chosen cancelled the assessment made by the Income-tax Officer in the Sec. 34 proceedings at the stage immediately preceding the assessment order and asked or directed the Income-tax Officer to recompute the income in a certain way and in that event no fresh notice under Sec. 34 would have been required. In my respectful opinion, therefore, the action of the Assistant Commissioner in enhancing the assessment at the appellate stage is in no sense illegal or without jurisdiction.

16. The following papers are submitted as Appendices to this statement:

1934-35.

(1) Assessment order		APPENDIX A.
(2) Grounds of appeal		,, B.
(3) Appeal order		,, C.
(4) The application under Sec. 66 (2)	...	,, D.

1932-33 under Sec. 34.

(5) Assessment order	...	APPENDIX E.
(6) Grounds of appeal	...	,, F.
(7) Appeal order	...	,, G.
(8) The application under Sec. 66 (2)	...	,, H.

W. JOHNSTON.

Commissioner of Income-tax, Bengal.

Isaacs and *S. Mitra*, for the Assessees.

The Advocate-General, *R.B. Pal* and *R.C. Pal*, for the Commissioner of Income Tax.

The JUDGMENT OF THE COURT was as follows:—

DERBYSHIRE, C.J.—The facts of this case are set out very fully in the case which has been stated by the Commissioner of Income Tax and I do not propose to re-state them here. There are, however, two matters which were admitted by both sides during the argument. The first is that we have been asked by both sides to decide this matter as if the return of income-tax by the North British Mercantile Insurance Company were made strictly under rules 25 and 35 made by the Central Board of Revenue under Sec. 59 of the Indian Income Tax Act, 1922.

Rule 25 provides:

"In the case of Life Assurance Companies incorporated in British India whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the life assurance business shall be the average annual net profits disclosed by the last preceding valuation, provided that any deductions made from the gross income in arriving at the actuarial valuation which are not admissible for the purpose of income-tax assessment, and any Indian income-tax deducted from or paid on income derived from investments before such income is received, shall be added to the net profits disclosed by the valuation."

Rule 35 provides:

"The total income of the Indian branches of non-resident insurance companies (Life, Marine, Fire, Accident, Burglary, Fidelity, Guarantee, etc.) in the absence of more reliable data, may be deemed to be the proportion of the total income, profits or gains, of the companies, corresponding to the proportion which their Indian premium income bears to their total income. For the purpose of this rule, the total income, profits or gains of non-resident Life Assurance Companies, whose profits are periodically ascertained by actuarial valuation shall be computed in the same manner as is prescribed in Rule 25 for the computation of income, profits and gains of Life Assurance Companies incorporated in British India."

The second is that the tax-free securities in question are Government of India tax-free securities which come within the proviso to Section 8 of the Indian Income Tax Act of 1922, the words of which are:

"Provided that no income-tax shall be payable on the interest receivable on any security of the Government of India issued or declared to be income-tax free."

The North British Company made a return for the year 1934-35 of the profits of its Life Business in India and the Income Tax Officer asked the Company to produce a certificate as to the composition of the interest item entering into the Life Business for the quinquennium 1926-30 in reply to which the following statement signed by the London Actuary of the Company dated the 5th of June, 1934, was submitted.

INDIAN INCOME TAX—

Life profits 1926-30—Indian business, Liability		Rs.
1st January, 1926, including new bonus	...	1,93,31,900
Premiums	...	1,21,93,333
Interest	...	48,08,196
		3,63,33,489
Claims	...	76,53,860
Surrenders and Bonus surrenders	...	12,20,285
Commission and Expenses of Management	...	27,43,600
Liability 31st December, 1930	...	2,20,92,009
Profit for Quinquennium	...	20,24,835
		3,63,33,489

Yearly profit for purpose of Indian Taxation 1931-32 to 1935-36, 1-5th of Rs. 26,24,835	...	5,24,967

"The interest collected in India during the quinquennium 1926-1930 on our Indian Life investments amounted to Rs. 40,75,703 as will be seen from the accompanying statement 'A'".

"The amount of interest considered to have been earned on the Indian Life business, however, during the same period, calculated at the average rate earned on the total Life funds of the Company, amounted to Rs. 48,08,196 and in computing the Indian Life Profits 1926-30 for the purposes of the valuation of our

Indian Life business, an amount of Rs. 7,32,488 has been added to the amount of the interest Rs. 40,75,708 collected in India in order to arrive at the figure of Rs. 48,08,196 credited in the valuation statement."

The statement " A " shows that the following amounts were received free of Indian Income Tax :

1926	...	2,04,790
1927	...	2,04,790
1928	...	2,04,790
1929	...	1,95,911
1930	...	22,577
		8,32,858

It was stated by the assessee's Counsel and accepted by the Advocate-General for the Income Tax authorities that the word "liability " in the table above should be read as " fund available to meet liability."

One-fifth of the amount of interest collected in India free of income-tax is Rs. 1,66,572. The assessees claim that this item of Rs. 1,66,572 comes within the exemption given by the proviso to Sec. 8 of the Act of 1922. The Income Tax authorities contend that the income, profits and gains are to be ascertained by rules 25 and 35, that those rules are a code complete in themselves and once the income, profits and gains have been ascertained under that code, it is not permissible in law to make any additions to or subtractions from that sum save in accordance with the provisions of rule 25. It is said that the total income so ascertained becomes only a notional income and unless otherwise provided by the rules, it is not open to the Income Tax authorities to introduce any dissection or analysis of that total, so as to allow the proviso to Sec. 8 to operate Great stress is laid by the Income Tax authorities upon the fact that the profits in the case of Life Assurance Companies are periodically ascertained by actuarial valuation.

It is, in my view, necessary to refer to the Life Assurance Companies Act (Act VI of 1912) for some indication as to what is the prescribed form and substance of that actuarial valuation. Sec. 7 of the Life Assurance Companies Act provides that every Life Assurance Company shall, at the expiration of each financial year, prepare—(*c*) a balance-sheet or balance sheets in the form or forms set forth in the Third Schedule,

Sec. 8 (*1*) provides—

"Every life assurance company shall once in every five years or at such shorter intervals as may be prescribed by the instrument constituting the company, or by its regulations or bye-laws cause an investigation to be made into its financial condition, including a valuation of its liabilities, by an actuary, and shall cause an abstract of the report of such actuary to be made in the form set forth in the Fourth Schedule."

The Fourth Schedule to the Act prescribes what is called "A consolidated revenue account for the......years commencing...... and ending......"

The statement of the Indian Income Tax Life profits 1926-1930 rendered by the North British Company dated the 15th of June, 1934, set out at page 3 of the Reference referred to above in general follows the forms of this Consolidated Revenue Account. In the right hand column of the Consolidated Revenue Account the last item is as follows: "Amount of Life Iusurance fund at the end of the period *as per Third Schedule.*" In the Third Schedule of the Act are set out the assets and investments of the Company and in the specimen form are shown "Indian Government Securities" and a space is left for the amount thereof. In the left hand column of the Consolidated Revenue Account (sixth schedule) there occurs this item "Interest, dividends and rents less income tax thereon."

It is clear, therefore, that the actuarial valuation prescribed for the Life Assurance Companies Act is not simply concerned with a final figure like the answer to an arithmetical sum but sets out the various assets of the Company and the interest derived form them. In fact it informs and is intended to inform all concerned what the assets and the income and liabilities of the Company are in a way which goes much beyond the ordinary company balance-sheet. It may be that the forms in Schedule 3 and Schedule 4 of the Act do not provide for each individual investment and item of interest to be set out. Nevertheless they do show the different classes of investment, the interest as a whole derived therefrom and the income tax paid thereon. If the assessee making a full and proper return chooses to show that he has certain tax-free investments and the income derived therefrom, it is in my view impossible to say that he has not made a proper return in accordance with the Life Assurance Companies Act of 1912. Where the return shows that some of the interest has been derived from securities of the Government of India declared to be

tax-free, it is impossible in my view for the Income Tax authorities to ignore the plain provisions of the proviso to Sec. 8 of the Income Tax Act which say that no income tax shall be payable on the interest receivable on any security of the Government of India issued or declared to be income tax free.

It was argued by the Income Tax authorities that rule 25 which is made under Sec. 59 of the Act has by sub-Sec. (5) thereof effect as if it were enacted in the Act. That is true. It was further argued that rule 25 overrules the provisions of Sec. 8 as far as Life Assurance Companies were concerned. I am unable to agree with that argument. In the case of the *Institute of Patent Agents* v. *Lockwood*, rules were made under the Patents, Designs and Trade Marks Act. The Act declared that rules which were made in the prescribed manner were to be of the same effect as if they were contained in the Act. The House of Lords held that this provision precluded enquiry as to whether the rules were *ultra vires* or not. At page 360 [of 1894 A.C.] Herschell, L. C., said:—

"No doubt there might be some conflict between a rule and a provision of the Act. Well, there is a conflict sometimes between two sections to be found in the same Act. You have to try and reconcile them as best you may. If you cannot, you have to determine which is the leading provision, and which must give way to the other. That would be so with regard to the enactment, and with regard to rules which are to be treated as if within the enactment. In that case, probably the enactment itself would be treated as the governing consideration and the rule as subordinate to it."

Those words were cited with approval by Lord Dunedin in the case of *Minister of Health* v. *The King*.

In the conflict here between the Income Tax authorities' contention under rule 25 and the assessees' contention under the proviso to Sec. 8 of the Act, it seems to me that the true position is that in this particular case the actuarial valuation as prescribed by law discloses the existence of item of interest Rs. 48,08,196. That item of interest was (at the request of the Income Tax Officer) shown to contain an item of Rs 8,32,858, interest derived from tax-free securities of the Government of India. That item of interest does not affect the liabilities of the company and clearly contributes *pro tanto* to the total profit concerned. In my view, therefore, it is not open to the Income Tax authorities to disregard that item or to say that it cannot be differentiated

from the total. In my view that tax-free interest or its annual one-fifth part must be deducted from the income, profits, and gains and is not assessable to income tax. I am fortified in this conclusion by the decision in the recent case of *Hughes* v. *Bank of New Zealand* where Lord Justice Greene said :—

"Section 46 of the Income Tax Act, 1918, provides that the interest of certain securities shall be exempt from tax and super-tax. The securities in question are securities which have been issued with a particular condition annexed to them, that condition being : 'that the interest thereon shall not be liable to tax or supertax, so long as it is shown, in manner directed by the Treasury, that the securities are in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom.' Speaking for myself, I find in that language a perfectly clear Legislative provision that, so long as the securities are in the beneficial ownership indicated in the section, no tax is to be levied in respect of the interest on them. To say, as has been said on behalf of the Crown, that the true effect of the section is merely that the interest is not to be taxed as interest but can be taxed as part of an aggregate of profits of trade, appears to me to override the perfectly plain language of the section."

In my view the answer to questions (1) and (2) propounded by the Commissioner of Income Tax is in the affirmative. The assessees may claim exemption from income-tax in respect of such part of the income, profits and gains of the Life Assurance Company as they can show are due to interest from securities issued by the Government of India declared to be income-tax free.

Question (3) is as follows :

"Whether, when income-tax for any year is charged in respect of income, profits and gains of a Life Insurance Company computed in the manner prescribed by the rules referred to in question 1, the assessee can claim credit under section 18 (5) of the Indian Income Tax Act, for any deductions of tax made at the source."

Sec. 18 sub-Sec. (3) provides :

"The person responsible for paying any income chargeable under the head 'Interest on securities' shall, (unless otherwise prescribed in the case of any security of the Government of India), at the time of payment, deduct income-tax (but not super-tax), on the amount of the interest payable at the maximum rate."

(There is a proviso which has nothing to do with the present case).

Sub-Sec. (5) provides:

"Any deduction made in accordance with the provisions of this section shall be treated as a payment of income-tax (or super-tax) on behalf of the person from whose income the deduction was made, or of the owner of the security, as the case may be and credit shall be given to him therefor in the assessment, if any, made for the following year."

The two sub-Sections refer entirely to deduction of tax at source by or on behalf of the Government of India and the giving of credit for such deduction when the assessees come to settle their final account for payment of income-tax with the Government in the following year They do not depend upon the way in which the tax is assessed. They are simply machinery for deducting tax at source and giving credit for that deduction in adjusting the final account. Indeed the Advocate-General who appeared for the income-tax authorities abandoned the contention which has been set out above by the Commissioner. In my view sub-Sec. (3) and sub-Sec. (5) of Sec. 18 apply equally whether the income of the assessee has been ascertained under rules 25 and 35 or not. In my opinion the answer to question (3) is in the affirmative.

The last question submitted by the Commissioner of Income-tax for our opinion is:

"Whether in any event, the Assistant Commissioner of Income-tax had jurisdiction to enhance the said assessment, having regard to the terms of the said notice under Section 34 and the general provisions of the Indian Income Tax Act, 1922."

In view of the answer I have given to the preceding questions it is not necessary for me to answer the last question.

The assessees are entitled to their costs in these proceedings.

COSTELLO, J.—The questions put for our consideration in this reference are of some complexity and difficulty. The matter which came to be argued before us arose out of the assessments made on the North British and Mercantile Insurance Company Limited for the years 1932-33, 1933-34 and 1934-35. The Commissioner of Income Tax stated that "the points at issue in respect of the assessments for the last two years are identical. Two further questions arise in respect of the assessment for the year 1932-33." These two questions were concerned with the legality of the action of the Income Tax Officer in initiating and making a supplementary assessment under Sec. 34 of the Income Tax Act and the legality of the Assistant Commissioner's action in enhancing the original assessment when the case came before him on appeal is also

challenged. The case stated by the Income Tax Commissioner related to the assessment for the year 1934-35 but it is clear that actually the questions we are required to answer are common to and govern the assessment for all the three years. The assessee's case was that the total income for the previous year (namely, the tax year ending the 31st December, 1933) amounted to the sum of Rs. 6,90, 883 and such income included a sum of Rs. 5,24,967 which represents the profits of the company's Indian Life Insurance Business, being one-fifth of the previous quinquennial surplus as ascertained by actuarial valuation of the business done by the Company from the 1st January, 1933, to the 31st December, 1933. The assessees' case was that in ascertaining that quinquennial surplus there had been taken into account interest on securities declared to be tax-free amounting in the aggregate to the sum of Rs. 8,32, 860 of which one-fifth would be the sum of Rs. 1,60,572. The Company was assessed to income-tax for the year 1934-35 on its aforementioned total income of Rs. 6,90,883 less the sum of Rs. 1,66,572 that is to say, on the sum of Rs. 5,24,311 which at 26 pies in the rupee amounted to the sum of Rs. 7,100-7 as. The surcharge thereon amounted to Rs. 17,715-2 as, and the total liability to income-tax for the year of assessment accordingly amounted to Rs. 88,715-9 as. The Company objected that they had already in point of fact paid income-tax for the year ending the 31st December, 1933, amounting to Rs. 1,16,953-1 anna 6 pies through deductions at source from interest on securities which deductions had been made by virtue of the provisions of Sec. 18 of the Income Tax Act. The Company put forward the objection that the Income Tax Officer in contravention and in disregard of the express provisions of sub-Sec. (5) of Sec. 18 had failed to give them credit for the full sum of Rs. 1,16,993-1-6p. when making the assessment although the assessment should have been taken as an assessment for the following year within the meaning of that sub-Section. The Income Tax Officer had, in fact, only given the Company credit for the sum of Rs. 51,332-6as. and so the Company complained that they had suffered double taxation to the extent of the difference, namely, Rs. 65,620-11-6 pies. The contention of the Company as regards the meaning and effect of Sec. 18, sub-Sec. (5) of the Act was that the provision of that Sub Section was clear, unambiguous in its meaning and mandatory. The Company argued that the provisions of the Sections could not be varied or modified by any rules or directions in any way whatever and therefore they were entitled as of statutory right to full credit

in the assessment for the whole amount of income-tax paid by them by reason of deductions from interest on securities during the year ending the 31st December, 1933. Accordingly when the Company appealed against the 1934-35 assessment they said that if proper credit has been given by the Income Tax Officer they would have been entitled to a refund of Rs. 28,202-8-6 pies but instead of that a demand was made on the Company for a further sum of Rs. 37,418-3 annas. The Company claimed in the appeal that their assessment ought to be reduced by giving them full credit of the tax previously paid in conformity with the precise provision of Sec. 18 Sub-Sec. (5) of the Act and the Company claimed a refund accordingly. When the matter came on appeal before the Assistant Commissioner of Income-tax, he set out the issue he had to determine in this form. "The objection of the Appellant lies against credit of tax paid at source, being allowed to the extent of Rs. 51,332-6 as in lieu of Rs. 1,16,953-1-6 pies" and in giving his decision he made the following observations: "The Income Tax Officer in making the assessment, has allowed credit, under the terms of Rule 27, of a sum equivalent to the average tax deducted at source, on investments over the period covered by the actuarial valuation. The Company, in the calendar year prior to the year of assessment derived a certain income from interest on securities, and it contends that it is entitled, under the terms of Sec. 18 (5) of the Act, to credit of a sum of Rs. 1,16,953-1-6 pies, this being the amount of tax paid at source in that year on account of income received by the Company in respect of securities. For reasons given by me in disposing of Appeal No. 25 of 1934-35-C-II, I am of opinion that the action of the Income Tax Officer was maintainable and that credit of the sum claimed, cannot be allowed. For reasons stated in my grounds of decision in Appeal No. 25 of 1934-35-C-II, I regard the total income of the Compay as being taxable under the head 'business and not dissectable in the manner in which the Income-tax Officer his dissected various sources of income in his assessment. The change in the classification of the head of income, has the effect of rendering the total income of Rs. 6,90,883 liable to tax at the maximum rate of 32½ pies. The Company has been duly called on to show cause why the assessment should not be enhanced owing to the change in the classification of income. The cause shown in this case is identical with the cause which has been shown in Appeal No. 25 referred to above. For reasons recorded in that appeal,

I am of opinion that the cause shown is not acceptable, and that the assessment is liable to enhancement."

The material part of the reasons given by the Assistant Commissioner of Income-tax was that he came to the conclusion that the whole of the life income of the assessee should be regarded as business income. The effect of that decision being that the assessees were liable to enhancement as the income previously regarded as accruing under the head tax-free securities would have to be charged to tax. It was consequent upon the order made by the Assistant Commissioner on the 13th March, 1935, that the assessees requested the Commissioner of Income-tax to refer the questions of law arising out of the decision of the Assistant Commissioner under Sec. 66 (2) of the Income-tax Act to the High Court. It was admitted that the returns made by the Company, although the Company was not registered in India, was upon the basis of Rules 25 and 35 made by the Board of Inland Revenue in exercise of the powers conferred by Sec. 59 of the Income-tax Act (XI of 1922) and promulgated by the Board of Inland Revenue Notification No. 3-I.T., dated the first April, 1922, as subsequently amended. The rules in question are known as the Indian Income-tax Rules, 1922. It is the meaning and effect of these rules that we have to consider. It is not necessary that I should re-state the questions of law which were formulated by the Commissioner of Income-tax in the case stated by him under Sec. 66 (2). Stated shortly, the points we have to consider and determine are these: How far, if at all, were the assessees entitled to claim exemption in respect of tax-free securities held by them and to claim credit in respect of taxes deducted at source from other securities held by them and lastly, what was the scope of the powers of the Assistant Commissioner of Income-tax as regards enhancing the assessment which originally came before him by way of appeal on an objection taken by the assessees themselves.

The contention on behalf of the Crown amounted to this: For the purpose of assessment to income-tax of an insurance business Company its income, profits or gains are determined in the manner prescribed by rules 25 to 35, and the figure arrived at on such basis is not open to any analysis nor can it be looked into or, as the Assistant Commissioner puts it, "dissected" for the purpose of ascertaining or determining the several elements going to make up or constitute the total. The Commissioner of Income Tax expressed the opinion that the question of determining

profit and loss of an Insurance Company is a very complex matter and it is with a view to avoid difficulties that "certain empirical rules were framed for assessment purposes" and that whatever might be the reason why the empirical rules were so framed in the way they were, the Income tax authorities are bound to apply those rules and nothing but the rules for the purpose of finding out the total income of an Insurance Company. The idea of the Commissioner of Income-tax is that the total income of Insurance Companies under the provisions of the relevant rules is only notional and unless it is otherwise provided by the rules themselves, it is not competent to the income-tax authorities to attempt or even consider any analysis of the total sum arrived at upon the basis of an actuarial valuation. The Commissioner of Income-tax took the view that "Sec. 10 of the Income-tax Act which provides for computation of business income (other than of Insurance Companies) will therefore not apply. The rules are intended to be self-contained provisions for the assessment of Insurance Companies and "to a case where these rules apply the provisions contained in Secs. 6 to 12 shall have no application," and he further says that this is the intention of the law will be evident from rule 30 which provides for allowing depreciation on assets (otherwise allowable under Section 10) and losses which are not ordinarily allowed. Again, in Rule 25, there is a provision for adding to the average annual net profits, the tax deducted from investments of the Company during the valuation period. If the other provisions of the Act applied, this provision in rule 25 would be redundant, for according to Sec. 18 (4) of the Act, the tax deducted at source is to be deemed to be income received. If the average annual net profits could be held as containing income from taxed securities, the provision of Section 18 (4) would have been applicable to that portion of the income. It is because it is Life Assurance business income and not income from interest on securities or from dividends as one of its components that it has been necessary to make provisions for giving credit of income-tax deducted from interest on the investments of a Company doing Life Assurance business. Further, the Commissioner of Income-tax is of opinion and it has been contended before us that Sec. 18 (5) of the Income-tax Act has no application to a case where the assessment is not made under different heads of income specified in Sec. 6 and so S. 18 has no application to a case like this.

The matter may be summed up in this way. The opinion of the Commissioner of Income-tax was and the argument put

forward before us on behalf of the Crown came to this that because a particular method is laid down by Rules 25 and 35 for the ascertainment of the taxable income of the Company's Life Insurance business, the figure put forward upon the basis of a quinquennial valuation must be taken finally and conclusively as being the amount of the profits or gains for the particular year in respect of which it is prepared. It is however not without significance that the form to be used in making a return of the total income of Companies required under Sec. 22 (1) (and the assessment originally made in the present case was under that section) is that prescribed by rule 18 of the Income Tax Rules, 1922. That Form contains this main heading: "Income, profits or gains as per profit and loss account for the year ending 19." Rule 18 requires that the Form should be accompanied by a copy of the profit and less account referred to therein. Then there are on the Form no less than twelve headings for stating additional items and then at the bottom of the Form there is in effect an instruction or at least an invitation to the Company making the return on the Form to deduct any amounts included in its accounts on account of

(*a*) Interest (net amount) on securities taxed at source...

(*b*) Interest on securities tax-free......

(*c*) Dividends (net amount) from Companies taxed in British India...

(*d*) Other items already taxed at source (specifies details)...

It was argued on behalf of the assessee that although the total income, profits or gains of an Insurance Company in respect of its Life Insurance business are to be ascertained in the peculiar manner prescribed by Rule 25 or Rule 35, it is nevertheless possible and permissible for the Company to make all or any of the deductions specified in the Form and show deductions in respect of the net amount of interest on securities taxed at the source and the interest on securities which are tax-free. An important point in favour of the case put forward on behalf of the assessees herein is that in Rule 25 itself there is a provision which enables those who are responsible for charging and collecting income tax to examine and probe the figure which is said to represent the amount of the average annual net profits disclosed by the last preceding actuarial valuation with a view to ascertaining whether any deductions had been made from the gross income in arriving at the actuarial valuations which are not admissible for the purpose of income tax assessment and there is also the further signi-

ficant provision that any income tax deducted from or paid on income derived from investments before such income is received, shall be added to the net profits disclosed by the valuation. It seems to me that if operations of an exploratory nature are available to one side, that is to say to the Crown, they should be equally available to those acting on behalf of the assessees or to the assessees themselves. In other words, if the Crown are permitted to *add*; the assessees or their advisers may in proper circumstances *subtract*. Some little difficulty is created for the assessees by reason of that provision of Rule 28 which says that in the case of other classes of insurance business (fire, marine, motor car, burglary, etc.) of a Company incorporated in British India, the income, profits or gains shall be determined in accordance with "the provisions of the Act," subject to the allowance specified in the rule next following. It might be said that the "provisions of the Act" are those contained in Secs. 6 to 12 which, as argued by the Commissioner of Income Tax and generally on behalf of the Crown, are to be altogether excluded from consideration as regards the assessment of Life Insurance Company, but I think Rule 28 can mean no more than that the income, profits or gains of a Company in respect of Insurance business carried on by it, other than Life Insurance business, are to be ascertained exactly in the same manner as the income, profits or gains, that is to say the total income, profits or gains of any other Company and so Rule 28 only operates as regards the first main item on the Form prescribed by Rule 18. If rule 21 is against the assessees, there are other Rules which, in my opinion, are in their favour. For example, income derived from the sale of tea grown and manufactured by the seller in British India shall be computed as if it were income derived from business and 40 per cent. of such income shall be deemed to be the income, profits and gains liable to tax as laid down in Rule 24 and the income, profits and gains of companies carrying on Dividing Society or Assessment business are to be dealt with in a special way as laid down in Rule 31. An argument put forward by the Commissioner of Income Tax and by the learned Advocate-General on behalf of the Crown in the hearing before us is this that Rules made under sub-Sec. (5) of Sec. 59 of the Income Tax Act, once published in the Gazette of India, take effect as if they were enacted in the Act itself. That is quite true but, all the same, Rules cannot take away rights conferred in the Act itself. This proposition, in my opinion, is so fundamental as to need no substantiation but it may not be inapt

to recall in this connection the pregnant words of MR. JUSTICE WILLS in the case of *The Queen* v. *Bird and Others : Ex parte Needes*, where he said :

"I only desire to add one other remark : the cases cited in argument may be wholly disregarded : they have really nothing to do with the present case. I desire in my judgment to adopt a broad principle which is too clear to need cases to be cited for its justification—the principle that where a power to make regulations is given to a public body by statute, no regulations made under it can abridge a right conferred by the statute itself."

I would refer also to the judgment of LORD HERSCHELL, L.C., in the case of *Institute of Patent Agents* v. *Joseph Lockwood*, who in his speech in the House of Lords as appearing in page 360, said :

"No doubt there might be some conflict between a rule and a provision of the Act. Well, there is a conflict sometimes between two sections to be found in the same Act. You have to try and reconcile them as best you may. If you cannot, you have to determine which is the the leading provision and which the subordinate provision, and which must give way to the other. That would be so with regard to the enactment and with regard to rules which are to be treated as if within the enactment. In that case probably the enactment itself would be treated as the governing consideration and the rule as subordinate to it."

It follows from this that where a scheme is framed by rules, even though they may have statutory authority, if any part of the scheme conflicts with an express provision of the Act, the rule will have to be disregarded. In the matter before us none of the rules we have to consider can be said, in my opinion, to be in direct conflict with any express provision in the Act and certainly none of the rules in terms derogate from any of the provisions of the Act itself or detract from the full operative effect of any of the sections even as regards life insurance business. The learned Advocate-General made what seemed to me an important admission when he suggested that as rules 25 and 35 contain directions for ascertaining the taxable income of life insurance companies (companies doing life insurance business), they should really find place somewhere in the region of Sec. 10 of the Act which deals with tax payable by an assessee under the head "Business" in respect of the profits or gains of any business carried on by him. Under rules 25-35 the income, profits and gains of life assurance companies, incorporated in British India, are determined by taking the annual average of the total profits disclosed by the last

actuarial valuation adding thereto any deductions made from the gross income in arriving at the actuarial valuation which are not admissible under the Income Tax Act, and adding also any Indian income-tax deducted from or paid on income derived from investments before such income is received. If the Indian income-tax deducted at the source from interest on investments exceeds the tax on profits thus calculated, a refund is permitted of the amount by which the deduction from interest on investments exceeds the tax payable as profits.

In my view, therefore, Rules 25 to 35 should not be taken as having any further effect than that they provide a somewhat arbitrary, though convenient method of ascertaining the *total* profits or gains in respect of Life Assurance business and so do not prevent the assessees from claiming and exercising the statutory right conferred by the second proviso to Section 8, although that section primarily is concerned with tax payable by an assessee under the head "Interest on securities." Nor do the Rules exclude the operation of what seems to me to be the definite and unequivocal directions contained in sub-Sec. (5) of Sec. 18. The fact that Sec. 10 sets out deductions or allowances which are permissible in respect of an assessment made under the head "Business", whereas the proviso to Sec. 8 seems to operate only where tax is payable under the head "Interest on securities," is in my opinion without significance; for it seems clear from the observations of Lord Wright, M.R., in the case of *Hughes (Inspector of Taxes)* v. *Bank of New Zealand* that a privilege or exemption ought always to be taken into account whether assessment is made under one part of a tax Act and or another part of the same Act. An examination of all the judgments of the Lords Justices in that case shows that it was held by the Court that the exemptions contended on behalf of the Bank of New Zealand were allowed upon that basis.

I accept the argument put forward by Mr. Isaacs on behalf of the assessees that as the Government of India securities held by the assessees are definitely and absolutely free from tax, the position of the North British and Mercantile Insurance Company, Limited, as regards the right to avail themselves of the second proviso of Sec. 8 of the Income Tax Act, ought to be deemed to be stronger than that of an assessee having securities which are merely free from tax in particular circumstances as for example in the case of non-residents.

Upon the question of whether the second proviso of Sec. 8 operates in relation to the tax-free securities possessed by the

present assessees, the words of LORD JUSTICE GREENE appearing at page 1003 in the report of the above cited case are much in point. The learned Lord Justice there says :—

"Speaking for myself, I find in that language a perfectly clear legislative provision that, so long as the securities are in the beneficial ownership indicated in the section, no tax is to be levied in respect of the interest upon them. To say, as has been said on behalf of the Crown, that the true effect of the section is merely that the interest is not to be taxed as interest but can be taxed as part of an aggregate of profits of trade appears to me to override the perfectly plain language of the section. It is a matter of some satisfaction that this construction which I consider should be placed upon the section will enable the perfectly clear undertaking given in the prospectus when this War Loan was issued to the public to be kept both in the spirit and in the letter."

In my view the North British and Mercantile Insurance Company, Limited, are entitled to the benefits of the provisions of Section 8 and of Sec. 18 (5) of the Indian Income Tax Act, 1922. Having regard to the view I take on these two main questions it is in my opinion neither necessary nor desirable that a definite answer should now be given on the other questions.

The result is that although I have felt some doubt in the matter, I agree with the judgment of my Lord the Chief Justice and I think the questions propounded by the Commissioner of Income Tax should be answered in the manner proposed.

PANCKRIDGE, J.—This is a reference made under Sec. 66 (2) of the Indian Income Tax Act, 1922, by the Commissioner of Income Tax, Bengal.

The assessees are an Insurance Company incorporated in Great Britain; the head quarters of their Indian business are at Calcutta, where they transact both Life and Fire Business.

Under Section 59 (1) of the Act the Central Board of Revenue may make rules for carrying out the purposes of the Act and for the ascertainment and determination of any class of income, and under sub-Section (2) (a) (ii) such rules may prescribe the manner in which, and the procedure by which, the income, profits and gains shall be arrived at in the case of Insurance Companies. Under sub-Sec. (5) such rules have effect as if enacted in the Act. The Central Board in exercise of this power have framed certain rules and those dealing with Insurance Companies are among rules 25 to 35 (both inclusive). By rule 35—

"The total income of the Indian branches of non-resident Insurance Companies (Life, Marine, Fire, Accident, Burglary, Fidelity Guarantee, etc.) in the absence of more reliable data may be deemed to be the proportion of the total income, profits or gains, of the companies, corresponding to the proportion which their Indian premium income bears to their total premium income. For the purpose of this rule, the total income, profits or gains of non-resident Life Assurance Company whose profits are periodically ascertained by actuarial valuation shall be computed in the same manner as is prescribed in rule 25 for the computation of income, profits and gains of Life Assurance Companies incorporated in British India."

The assessees in this case are a non-resident Life Assurance Company within the meaning of rule 35.

Rule 25 is as follows:—

"In the case of Life Assurance Companies incorporated in British India whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the Life Assurance Business shall be the average annual net profits disclosed by the last preceding valuation, provided that any deductions made from the gross income in arriving at the actuarial valuation which are not admissible for the purpose of income tax assessment, and any Indian income tax deducted from or paid or income derived from investments before such income is received, shall be added to the net profits disclosed by the valuation."

I take it the correct procedure would be to ascertain the profits of the assessees' Life business all over the world by actuarial valuation in the manner contemplated by rule 25, and attribute to the assessees' Indian Branch that proportion of the profits that the Indian premium income bears to the total premium income, and then to divide the result by the number of years covered by the valuation.

For some reasons or other this was never done, and in every assessment the Indian Life Business of the assessees was treated as the Life Assurance business of a Life Assuraance Company incorporated in British India is treated under rule 25.

Whether the result thus arrived at was considered to be "more reliable data" within the meaning of rule 35 is not clear, but the matter is of no importance as the procedure contemplated by rule 25 has been accepted as appropriate both by the assessees and by the Department.

Until the assessment for the year 1932-33 the Income Tax Officer appears to have assessed the Company on the following lines. He took a fifth of the profits as shown by the actuarial valuation of the profits of the last quinquennium (five years being the period for which it was the practice of the assessees to value the profits), and added thereto the profit on the Fire Business. This gave him the total income of the assessees as defined by Section 2 (15) of the Act.

He then proceeded to make certain deductions based on figures furnished by the assessees at his request.

One of these deductions was one-fifth of the total of the receipts of the assessees during the quinquennium of interest on securities from which income-tax had been deducted at source under Section 18 (3) of the Act.

The other deduction was one-fifth of the total of the receipts of the assessees during the quinquennium of interest on tax-free securities.

He then proceeded to treat what was left of the total income as taxable income for purposes of income-tax.

In the year 1933 the assessees' assessment came before the successor of the former Income-tax Officer; he noticed, as was undoubtedly the fact, that the deductions made from the interest on securities under Section 18 (3) had been made in most cases, if not in all, at rates of tax lower than the rates appropriate to the year of charge.

He accordingly served the assessees with a notice under Section 34, calling on them for a fresh return of their income from all sources for the year ending March 31st, 1933, and declared his intention of re-assessing the income at the correct rate.

Calling for the return was really an unnecessary formality, for there was no question as to the correctness of the figures in the assessees' first return.

He proceeded to correct what he considered to be his predecessor's error in the following way. He included one-fifth of the quinquennium's interest from taxed securities in the taxable income which he taxed at the rate of the year of charge after giving credit for one-fifth of the deductions at source actually made during the quinquennium. He followed the former assessments in excluding one-fifth of the interest on tax-free securities from the taxable income.

The assessees appealed against the order of re-assessment to the Assistant Commissioner of Income-tax.

In their appeal they questioned the power of the Income-Tax Officer to re-open the assessment under Sec. 34, and also complained that whereas they had had a sum of Rs. 81,414-8-1 deducted at source during the previous year, *i.e.*, the accounting year January 1st, 1931, to December 1st, 1931, they had only been given credit in the year of assessment 1932-33 for Rs. 51,332-6-0 (one-fifth of the quinquennium's deductions) in contravention of Sec. 18 (5).

The Assistant Commissioner rejected the assessees' contentions and in addition enhanced the assessment in exercise of his powers under Sec. 31 (3) (*a*) by disallowing the deduction from the total income of one-fifth of the interest on tax-free securities received during the quinquennium, thus increasing the taxable income by Rs. 1,66,572.

The assessments for 1933-34 and 1934-35 have been made in accordance with the final assessment for 1932-33 after enhancement by the Assistant Commissioner.

The Commissioner has been required under Sec. 66 (2) of the Act to refer certain questions of law to this Court and he has referred four questions. Three of these are concerned with the assessments for the years 1932-33, 1933-34 and 1934-35, and the fourth only with the assessment for 1932-33.

The three questions which concern all the assessments have been formulated as follows :—

Question 1—

Whether when the income, profits and gains of a Life Assurance Company are arrived at for the purpose of charging income-tax for any year, in the manner prescribed by Rule 35 read with Rule 25 of the rules made by the Central Board of Revenue in exercise of the powers conferred by Sec. 59 of the Indian Income-tax Act (Act XI of 1922), it is open to the assessee to go behind this notional figure by referring to the actual sources of its receipts and claim exemption from taxation in respect of any portion of the income.

Question 2—

Whether, when the income, profits and gains of a Life Assurance Company are arrived at for the purpose and in the manner specified in question 1, and income-tax is charged in respect of such amount, it is open to the assessee to go behind this notional figure and refer to the actual sources of its receipts in order to claim that a portion of the total income calculated represented income chargeable under the head "interest on securities."

Question 3—

Whether when income-tax for any year is charged in respect of income, profits and gains of a Life Insurance Company computed in the manner prescribed by the rules referred to in question 1, the assessee can claim credit under Sec. 18 (5) of the Indian Income-tax Act, for any deductions of tax made at the sources.

Counsel for the assessees has objected to the form in which the questions have been raised, and I agree with him that it is open to criticism. Because a question is a question of law, it is not necessary to state it in a general form and indeed it is often preferable to formulate it with reference to the facts of the particular case. However, there really has been no doubt as to the substance of the dispute between the assessees and the Crown, and it would serve no useful purpose to remand the reference in order to have the form of the questions amended.

The first question is concerned with the interest received in respect of tax-free securities and I should have preferred to express it thus—

"Are the assessees entitled to deduct from their total income in each year of assessment a sum equal to one-fifth of the interest on tax-free securities received during the quinquennium as being free from income-tax?"

The assessees contend that if they are not allowed the deduction they are deprived of the advantages conferred by the second proviso to Sec. 8 which is as follows:—

"Provided further that no income-tax shall be payable on the interest receivable of any security of the Government of India issued or declared to be income-tax free.

They state, quite truly, that if their privilege is to be curtailed by the rules made under Sec. 59 (2) (*a*) (*ii*), this must be done in unambiguous language, and that there is nothing in the rules that purports to curtail it.

Their submission is that the method of ascertaining the income, profits and gains laid down by rule 25 merely prescribes a way of arriving at or computing the total income of Life Assurance Companies, and that the income, profits and gains when so computed must be charged in accordance with Chapter III of the Act.

Now, in my opinion, the primary charging section of the Act is Sec. 3 which provides that tax shall be charged in accordance with and subject to the provisions of the Act in respect of all income, profits and gains of the previous year.

The effect of this is to make all income, profits and gains of the previous year taxable, subject to the provisions of Chapter III in respect of those parts of them that can be brought under the heads of income, profits and gains, set out in Sec. 6.

It follows that before the assessees can complain that the assessment violates the second proviso to Sec. 8, they must show that the tax demanded is being demanded in respect of income, profits and gains which are covered by the section as being "interest on securities."

In my judgment the assessees have failed to establish this. What is to be assessed to tax is the annual average net profit disclosed by the last preceding valuation with the additions provided for by rule 25. I find it impossible to hold that any part of the annual average of the result of an actuarial valuation can be "interest on securities" within the meaning of Sec. 6 and Sec. 8 of the Act.

For the purposes of tax it does not seem to me to be feasible to attribute a portion of the actuarially ascertained figure to one particular factor among a number of factors forming the basis of the valuation.

I must notice one argument advanced by Counsel for the assessees which to my mind is misleading. On page 3 of the statement of the case by the Commissioner appears an analysis furnished at the Income-tax Officer's request by the assessee's London actuary. Counsel submitted to us that this analysis disclosed the fact that the so-called actuarial valuation is really nothing more than a profit and loss account over a period of five years in which the liabilities, though larger and more difficult of ascertainment, are in essence the same "contingencies" appearing in the ordinary trading firm's accounts.

This however is not an accurate picture, since the interest shown—and interest is the very factor with which we are concerned—exceeds by almost one-fifth the interest actually received in India by the assessees in order to bring it up to the rate of interest received all over the world. I assume it involves a corresponding writing down at some other branch. In the absence of expert evidence I am by no means convinced that the statement is as simple as Counsel maintains.

Apart from the particular statement, however, there is no warrant for the assumption that all actuaries follow the same methods, and it is clear that the liability of any particular Life Insurance Company to tax cannot depend upon the possibility of

tracing a particular factor in its actuarially ascertained valuation.

I expressed this opinion in the course of the argument, and I was certainly fortified in it when we came to deal with the reference concerning the Phoenix Assurance Company, Limited, whose assessment is disputed on similar grounds. This Company follows the procedure under rule 35. That is to say, its Indian income, profits and gains are computed to be the part of its world wide profits and gains actuarially ascertained, proportionate to that part of the premium income attributable to India. No attempt was made, and no attempt could in my opinion possibly be made to identify any part of the Indian income, profits and gains thus ascertained with the interest on tax-free securities received in India during the quinquennium.

As regards the case of *Hughes* v. *Bank of New Zealand* where it was decided that a non-resident Bank was entitled to the exemption provided by Sec. 46 (1) of the Income Tax Act, 1918, in respect of the interest payable on 5 per cent War Loan and that such interest could not be taxed under Schedule D as part of the profits of a trade carried on in this country by the London Branch, it appears to me that what the Court of Appeal decided is what has never been questioned in India, and is indeed specifically recognised in the statutory forms of return prescribed under Rules 18 and 19.

This is that an assessee who has included in his trading accounts profits or income on account of (*inter alia*) "interest on securities tax-free" may deduct such profits and income from his total income and is only taxable on the balance.

The case however does nothing to help the assessees to surmount what in my opinion is the real difficulty in their way here, namely that, as they are a Life Assurance Company, their income, profits and gains are statutorily ascertained under the rules in such a way that they cannot be sub-divided under the heads of income in Sec. 6 of the Act and in consequence no part or proportion of them is interest on securities within the meaning of Sec. 8.

While considering the question of hardship, I wish to refer to an argument advanced by the learned Advocate-General which in my opinion is not easy to meet. In the ordinary business the income, profits and gains for any period are the excess of incomings over outgoing subject to such deductions as are allowed by the Act. Sums placed to reserve are not permissible deductions, a fact which is recognised in the forms prescribed by rules 18 and 19. Before

however the income, profits and gains of Life Insurance business are computed the Company is permitted to transfer to "liability" "Life Surplus" the sum necessary to bring that fund up to actuarial requirements.

The Advocate-General submits and I agree with him that there is no principle upon which the sum so transferred must be attributed to what in the case of an ordinary business would be taxable while the whole of the income derived from tax-free sources is to be held to be included in the balance liable to assessment.

It is not necessary to decide whether, as the learned Advocate-General has submitted, the rules form a complete and self-contained code to the exclusion of Chapter III, or whether the income, profits and gains come under the head of "other sources" in Sec. 6.

It is sufficient to say that the assessees have not been able to show that Rs. 1,66,572 out of the income, profits and gains in the three years of assessment amounting to Rs. 5,24,967 is "interest on securities" within the meaning of Sec. 6. This being so, Sec. 8 and the proviso thereto have no application, and the first question in the form in which I have stated it, must be answered in the negative. I should add that I have reached the conclusions I have set out above with great hesitation, since they are at variance with those arrived at by the other members of the Court.

The second point for decision concerns the claims of the assessees to be given credit for the sums actually deducted at source from the interest on taxable securities in the assessment made in the year succeeding the accounting year in which deductions are made.

I think the issue is fairly raised by the third question as framed by the Commissioner. The second question appears to be unnecessary, and to be an attempt to bring the two contentions put forward by the assessees under one head. The points have however little or nothing to do with one another.

It is conceded by the Crown that if the deductions were made in accordance with the provisions of Sec. 18, then sub-Sec. (5) gives the assessees a right to claim credit in the following year.

It is further conceded that for the purposes of these assessments the "previous year" means the twelve months ending with the last day of the year last preceding the beginning of the year of charge.

The Advocate-General did not seek to support that part of the Commissioner's opinion, where he says that "the previous year" in the case of Life Assurance Companies is not the preceding year, but a year of the preceding valuation period. I too am of opinion that the Commissioner's opinion is erroneous in this respect. The Central Board of Revenue have never purported to determine the period under Sec. 2(11)(b), and I think that in any case the powers of the Board are confined to determining an actual period.

Indeed the phrase "average year" has really no meaning, though it is popularly used to describe a year, a particular characteristic of which, for example, birth-rate, rainfall, or jute crop, does not markedly exceed or fall short of the average ascertained over a series of previous years.

At first I thought that if the Crown were right in the submission that the rules excluded Chapter III of the Act, the deductions could not be said to be made in accordance with the Act, and therefore Sec. 18 (5) had no application. For, although Sec. 18 is not part of Chapter III, the words "income chargeable under the head of 'Interest on Securities'" in Sec. 18 (2) must have reference to the classification in Sec. 6.

This would have been a most unsatisfactory position, for although it is possible that the assessees might have claims under Sec. 48-A to a refund of the deductions improperly made, their claims might be time-barred under Sec. 50.

However the Advocate-General maintained that the deductions had been validly made under Sec. 18 (3), and he was constrained to state that in face of that contention, although he was not in the position to make a formal admission, he could not usefully dispute the claim of the assessees to be given credit under Sec. 18 (5).

It follows that the answer to the third question propounded by the Commissioner is in the affirmative.

The Commissioner has referred the following question with respect to the assessment for 1932-33 :—

"Whether in any event, the Assistant Commissioner of Income-tax had jurisdiction to enhance the said assessment, having regard to the terms of the said notice under Sec. 34 and the general provisions of Indian Income Tax Act, 1922."

This question occasions me considerable difficulty because having regard to the opinion that we hold as to the effect of Sec. 18 (5), the action of the Income Tax Officer was based on a fundamental misconception of the law.

What the assessees were entitled to was credit in the year of charge for the deductions at source made in the preceding year, without any reference to the average of deductions made during the quinquennium.

There was no question of any income escaping assessment, for it had all been checked and assessed. This is borne out by the notice given by the Income Tax Officer which begins as follows:—

"Whereas I have reason to believe that your income from interest on securities which has been assessed in the financial year ending 31st March, 1933, has been assessed at too low a rate and I therefore propose to assess your income at the current rate. . . ."

Now it is noticeable that under the Indian Act all taxable income pays tax at the rate or rates applicable to the total income of the assessee (see Sec. 3) and there is nothing in the Act corresponding to what is called the "slab" system of taxation.

It is therefore difficult to see how a particular part of an assessee's income can be taxed at too low a rate.

Be that as it may, the Income Tax Officer proceeded to reassess in the manner I have described, and the assessees appealed to the Assistant Commissioner, questioning the jurisdiction of the Income Tax Officer to reassess under Sec. 34 and putting forward the contentions are regards the effect of Sec. 18 (5) that we have found to be correct. The Assistant Commissioner supported the Income Tax Officer and also enhanced the assessment by disallowing the deduction of 1-5th of the interest on tax-free securities.

The most comprehensive ground, on which the power of the Assistant Commissioner to enhance is questioned, is the submission that the words "In disposing of an appeal" in Sec. 31 (3) confine the powers of enhancement to those items in the assessment which are the subject of the appeal.

In my opinion it is not necessary to give our decision as to the soundness of this argument, but my own view is that the language is too wide to permit of so restricted a construction. It may be that the words are intended to make it clear that the Assistant Commissioner has no power to act of his own motion but must have an appeal before him.

There is more to be said for the argument that when what is appealed against is an assessment or reassessment under Sec. 34, the Assistant Commissioner is bound to confine himself to what is covered by such assessment or re-assessment and cannot deal with

matters covered by a previous assessment made under Sec. 23. I think this argument is to some extent supported by the decisions in *In re Satyendra Mohan Roy Chaudhuri* and *Seth Kasinath Bagla* v. *The Commissioner of Income Tax, United Provinces.* But although this principle is comparatively easy to apply when income that has originally escaped assessment has been assessed under Sec. 34, its application is more difficult when the Income Tax Officer has purported to reassess on the basis that income has been assessed at too low a rate.

I prefer to base my decision that the Assistant Commissioner had no power in this case to enhance on the ground that the re-assessment under Sec. 84 was on the face of it without jurisdiction and as such should have been annulled with the result that the original assessment under Sec. 23 would have stood.

What had happened was that credit has been allowed on a wrong basis, in this case to the detriment of the assessee. It appears to me that there could not properly be said to be assessment at too low a rate or an escape from assessment so as to give the Income Tax Officer jurisdiction to reopen.

In saying this I must not be thought to be assenting to the view that an Income Tax Officer can only proceed under Sec. 34 where he can show affirmatively at the outset that income has escaped assessment, and is precluded, when he has reason to believe that there has been an escape, from using the section as a basis of investigation. As to that I express no opinion. It does however seem to me that where an assessee rightly objects to an assessment or reassessment under Sec. 34 on the ground that the proceedings are bad on the face of them, the powers of the Assistant Commissioner cannot extend to enhancing an assessment, which the Income Tax Officer had no jurisdiction to make and must be limited to annulling it as made without jurisdiction.

In the result, questions 1 and 2, as framed by the Commissioner, subject to what I have said as to their form ought in my opinion to be answered in the negative.

Question 3 must be answered in the affirmative.

Question 4 which deals with the Assistant Commissioner's power to enhance must be answered in the negative.

Solicitors: *Orr, Dignam & Co.* for the Assessees: *R. C. Pal* for the Income Tax Department.

[IN THE CALCUTTA HIGH COURT.]

THE PHOENIX ASSURANCE CO., *In re.*

SIR HAROLD DERBYSHIRE, C. J., COSTELLO, J., and PANCKRIDGE, J.

March 20, 1937.

INSURANCE COMPANY—ASCERTAINMENT OF PROFITS UNDER RULES 25 AND 35—RIGHT TO CLAIM EXEMPTION IN RESPECT OF INTEREST ON TAX FREE SECURITIES AND TO CLAIM CREDIT FOR TAX DEDUCTED AT SOURCE—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 8, 18 (5)—INCOME TAX RULES, RR. 25, 35.

If an insurance company carrying on business outside British India as well as in British India satisfies the income-tax authorities that they have received interest on Government securities which are tax-free and that it has been reckoned in the computation of their total world-wide funds, the company is entitled to have the same proportion of that tax-free interest that the Indian premiums bear to the world-wide premiums, deducted from their income, profits and gains assessed under Rules 25 and 35 of the Income Tax Rules and exempted from tax.

When the income, profits and gains of a life insurance Company are arrived at in the manner prescribed by Rule 35 read with Rule 25, it is open to the Company to go behind this notional figure by referring to the actual sources of its receipts and claim exemption from tax in respect of interest on tax-free securities which had been taken into account in arriving at this notional figure; it is also open to the Company to claim credit under Sec. 18 (5) of the Income Tax Act for any deductions of tax made at source.

Case stated by the Commissioner of Income Tax, Bengal, under Section 66 (2) of the Indian Income Tax Act (XI of 1922), in the matter of the assessment of the Phoenix Assurance Co., Ltd., for the year 1934-35.

STATEMENT OF CASE.

On the application of the assessees, the Phoenix Assurance Company, Limited, this Statement of Case is submitted to Their Lordships, the Judges of the Calcutta High Court, for a decision on the questions of law formulated in Paragraph 8 below :—

2. **Facts of the Case** :—The applicant which is an Insurance Company incorporated in England, has asked for a reference in

respect of the assessments for the years 1932-33, 1933-34 and 1934-35. As the facts and circumstances regarding the questions of law which I shall refer for their Lordships' decision are identical in respect of all the three years I propose to state a case for the year 1934-35 only and to decide the questions at issue in the assessments for the other two years in accordance with Their Lordships' decision on this reference.

3. This Company does business in life insurance, fire, marine and accident insurance in India as well as in other parts of the world. The assessment for the year 1934-35 has been made on a total income of Rs. 2,89,407. Of this the income from life business is Rs. 3,13,195 while taking together fire, marine and accident business there has been a loss of Rs. 23,788, the resultant figure being Rs. 2,89,407 as stated above.

4. In accordance with Section 59 (2) (a) of the Income-tax Act, the Central Board of Revenue may make Rules for prescribing the manner in which, and the procedure by which the income, profits and gains shall be arrived at in the case of insurance companies. According to Clause (5) of Section 59, Rules made under this section shall have effect as if enacted in this Act. The Central Board of Revenue have framed Rules and so far as they are relevant to this case they are Rules 25, 27, 30 and 35 to be found at pages 112-114 of the Income Tax Manual (6th Edition). In accordance with Rule 35, the total income of the Indian branches of non-resident insurance companies (life, marine, fire etc.) in the absence of more reliable data, may be deemed to be the proportion of the total income, profits and gains, of the companies, corresponding to the proportion which their Indian premium income bears to their total premium income and for the purpose of this Rule, the total income, profits or gains of non-resident life Assurance Companies whose profits are periodically ascertained by actuarial valuation shall be computed in the same manner as is prescribed in Rule 25 for the computation of income, profits and gains of Life Assurance Companies incorporated in British India. Rule 25 reads as below :—

"In the case of Life Assurance Companies incorporated in British India whose profits are periodically ascertained by actuarial valuation the income, profits and gains of the Life Assurance Business shall be the average annual net profits disclosed by the last preceding valuation, provided that any deductions made from the gross income in arriving at the actuarial valuation which are not admissible for the purpose of income-tax assessment, and, any

Indian income-tax deducted from or paid on income derived from investments before such income is received, shall be added to the net profits disclosed by the valuation."

The computation or profits in the case under discussion has been made in accordance with Rule 35, read with Rule 25. In the Life Business there are three separate headings, *viz.*, (1) Phoenix Fund, (2) British Empire Fund and (3) Positive Fund. The average annual net profit disclosed by the last preceding actuarial valuation which has been made the basis of the assessment under discussion is of the quinquennial period ending 31st December 1930 in respect of No. (1). For Nos. (2) and (3) the period is the quinquennium ended 31st December 1931, average annual profit of the quinquennial valuation periods mentioned above has according to the provisions of Rule 25 been taken as income of the previous year. The Company submitted before the Income-tax Officer the valuation statement of the Phoenix Fund for the quinquennial period ended 31st December, 1930, as well as of the two other Funds, *viz.*, British Empire Fund and Positive Fund for the quinquennial period ended 31st December, 1931, showing the results of their all world income. The consolidated revenue accounts and the valuation Balance sheets are reproduced in Appendix A.

5. In the return which the Company submitted for the assessment year under discussion they showed the following :—

Income, profits or gains as per profit and loss account for the year ended 31st December, 1933 ...	Rs.	2,89,407-1-0.
	Total	2,89,407-1-0.

as per computed statement submitted.

Deduct—Any profits included in the accounts already charged to Indian income-tax and the interest on securities of the Government of India or Local Governments declared to be income-tax free ...	31,362-0-0
Balance	2,58,045-1-0

The "computed statement" referred to above is reproduced below :—

INDIAN INCOME TAX 1933 (FOR ASSESSMENT 1934-35).

Marine Profit ... Rs. 6,673-0-0	
Accident ... Rs. 0-3-1	
	6,673-3-1
Fire loss	30,461-2-0
Loss ...	23,787-14-11
Average annual life Profits as per Statement V	3,13,195-0-0
Profit ...	2,89,407-1-1
Less average tax-free interest as per Statement V	31,362-0-0
Amount taxable ...	2,58,045-1-1

TAX LIABILITY.

Rate of tax.	Amount subject to rate shown.	Tax.
29¼ pies per Rupee ...	Rs. 13,600	2,072-15-0
26 ,, ,, ...	Rs. 13,850	1,875- 8-0
19 ,, ,, ...	Rs. 73,096	7,233- 7-0
18 ,, ,, ...	Rs. 1,57,492	14,764-14-0
Total ...	Rs. 2,58,045	25,946-12-0
Average tax deducted at source (as per Statement V)	...	49,163- 0-0
Refund of Income-tax due	...	23,216- 4-0

STATEMENT V.

PHOENIX ASSURANCE COMPANY, LIMITED.

Life Assurance Business.

Tax due on average profits.

	Rs.
Profits of Phoenix for 5 years ending 31st December 1930 as per Statement II ...	13,86,387
Profits of British Empire for 5 years ending 31st December 1931 as per Statement III	2,24,640

Profits of Positive for 5 years ending 31st December 1931 as per Statement IV ...	4,947
Total ...	15,65,974
Annual average of Profit one-fifth ...	3,13,195
Tax deducted at source.	
Phoenix Fund for 5 years ending 31st December 1930 (Statement II) ...	1,71,164
British Empire Fund for 5 years ending 31st December 1931 (Statement III) ...	52,228
Positive Fund for 5 years ending 31st December 1931 (Statement IV) ...	22,421
Total ...	2,45,813
Average Tax deducted per annum one-fifth	49,163

TAX FREE INTEREST RECEIVED.

Year.	Phoenix.	Year.	British Empire.	Positive.
	Rs.		Rs.	Rs.
1926	60,228	1927	27,104	600
1927	45,801	1928	330	600
1928	20,348	1929	Nil.	600
1929	Nil.	1930	Nil.	600
1930	Nil.	1931	Nil.	600
	1,26,377		27,434	3,000

The amount of tax-free interest received Rs. 1,56,811

Average amount of tax-free interest received per annum, *viz.*, one-fifth Rs. 31,362

INDIAN INCOME TAX 1933 (FOR ASSESSMENT 1934-35).

Phoenix Life Fund.

Profits based on Valuation as at 31st December 1930.

		£	
Life fund surplus	...	990,698	(vide Board of Trade Returns, page 9).

Deduct amount brought forward :—

Participation Fund	...	93,996
Survivors' Bonus Fund	...	1,382

Non-Participation Fund ...	82,667		
		128,045	do.
		862,653	
Brought forward ...		862,653	
Add Interim Bonus paid:—			
Participation Fund ...		53,601	
Survivor's Bonus Fund ...		1,998	
Transferred to share-holder Accounts:—			
Non-Participation Fund ...		200,000	
British Income-tax ...		333,908	
Dominion and Foreign taxes (part of item of £ 19,980) ...		10,347	
			599,854
			£ 1,462,507-A.

For the 5 years ending 31st December 1930:—

Indian Premiums ... £ 339,303-B.

Total Premiums ... £ 4,251,015-C. (Vide Board of Trade Returns page 2).

$\frac{B}{C} \times A$ - £ 100,229-Rs. 13,36,387.

For year.	Tax deducted at source from interest Rs.	Super-tax Rs.
1926	31,024	8,873
1927	33,277	9,456
1928	35,044	9,017
1929	35,423	8,949
1930	36,396	8,735
	1,71,164	45,030.
	2,16,194	

STATEMENT III.

INDIAN INCOME TAX 1933 (FOR ASSESSMENT, 1934-35).

BRITISH EMPIRE FUND.

Profits based on Valuation as at 31st December, 1931.

Surplus ... £ 224,365 (Board of Trade Returns, page 6).

Less ...	£ 27,538		
Amount brought forward. Amount set aside as at 31st December 1926 as a supplement to the "Positive" Funds	£ 3,327		
		—30,865	(Board of Trade Returns, page 6].
		193,500	
Add—Interim Bonus paid		45,213	Do.
British Income-tax ...		62,555	Do.
Dominion and Foreign Taxes		5367	Do.
		£306,639-A.	

For the 5 years ending 31st December 1931 :—

Indian Premiums ... £ 7,086-B.

Total Premiums ...£ 128,963-C. (Board of Trade Returns, page 1)

$\frac{B}{C} \times A$- £ 16,848-Rs. 2,24,640.

	Tax deducted at source from interest. Rs.	Super tax paid. Rs.
1927	9,999	4,027
1928	9,935	3,840
1929	8,292	3,811
1930	9,593	3,720
1931	14,409	4,359
	52,228	19,757
	71,985	

STATEMENT IV.

INDIAN INCOME TAX 1933 (FOR ASSESSMENT, 1934-35).

POSITIVE FUND.

Profits based on Valuation as at 31st December 1931.

Deficit ... £ 851 (Board of Trade Returns, page 10).

Deficit brought forward £ 3,327 (Board of Trade Returns, page 6).

Profit	...	2,476
Add :—		
British Income Tax	...	5,662
Dominion and Foreign Taxes	...	815
		8,953-A.

For the 5 years ending 31st December 1931 :—

Indian Premiums	...	176-B.	
Total Premiums	...	4,248-C.	(Board of Trade Returns, page 9).

$\frac{B}{C} \times$ A- ... 371-Rs. 4,947.

	Tax deducted at source from interest. Rs.	Super tax paid. Rs.
1927	4,237	941
1928	4,185	898
1929	4,082	891
1930	4,156	870
1931	5,761	1,019
	22,421	4,619
	27,040	

6. In accordance with the provision of Rule 35 read with Rule 25 of the Rules under the Indian Income Tax Act the total Income of the Indian branch was worked out as below :

(1) Phoenix Fund :—

		Rs.
Indian surplus for the quinquennium ended 31st December 1930	...	13,31,387.

(2) British Empire Fund :—

Indian surplus as already worked out for the quinquennium ended 31st December 1931	...	2,24,640.

(3) Positive Fund :

Indian Surplus (as already worked out) for

the quinquennium ended 31st December 1931	...	3,947.
		15,65,974.

Thus the average annual net profits as disclosed by the last preceding valuation and as shown by the Company itself was Rs. 3,13,195. This had to be taken as the total income of the life Assurance business for the relevant accounting year. The Company showed a loss of Rs. 23,788 for Fire, Marine and Accident business taken together. Allowing this loss the Income-tax Officer made the assessment on a sum of Rs. 2,89,407. The assessee Company claimed a further deduction from its taxable income in respect of the sum of Rs. 31,362 which was stated to be the average of interest on tax free securities received by the Company during the period from 1926 to 1933. The Income-tax Officer disallowed this claim. The assessee Company further claimed that from the tax charged in respect of its total income the sum of Rs. 49,163 should be deducted as tax already deducted at the sources. This latter figure, as will be seen from the computed statement, is the average of the tax deducted at sources during the valuation periods. The Income-tax Officer allowed this claim and deducted this sum of Rs. 49,163 from the tax assessed. The Company appealed before the Assistant Commissioner of Income-tax. According to the case made before the Income tax Office their only grievance was in respect of interest on tax free securities and there should have been no complaints so far as tax deducted at the sources was concerned. But while preferring this appeal the assessee discovered a new grievance in respect of the second item also though their claim as made before the Income-tax Officer was fully allowed by him. A copy of the grounds of appeal will be found in Appendix "C." These were that the Income Tax Officer erred in assessing income tax on the portion of the Company's income that consisted of interest on tax-free securities and that the Income Tax Officer erred in not giving credit for income tax deducted at source to which the Company was entitled under Section 18 (5) of the Act or otherwise. The second ground was more clearly expressed in their petition of appeal against assessment for 1933-34 which ran as follows:

"That the Income-tax Officer erred in regarding as a deduction at source the annual average of tax deducted from the

interest on the Company's investments instead of taking the tax actually paid during the particular year of assessment."

The assessee now stated that during the previous year (*i.e.*, the year ended 31st December, 1933) the sum of Rs. 92,252 was the amount actually deducted at sources from interest on securities. This appeal was heard by the Assistant Commissioner along with the appeals for the assessment year 1932-33 and 1933-34 and during the hearing of these appeals all of which were disposed of on the same day, the Assistant Commissioner allowed the appellant an opportunity of proving that the annual average net profits included any amount on account of tax-free securities. In response to this the Company submitted a certificate from its Actuary which reads as below:

PHOENIX ASSURANCE COMPANY LIMITED.

Of Phoenix House, King William Street, London E. C. 4. Certificate of the Receipt of interest from Tax free Securities.

"I hereby certify that the undermentioned amounts of interest totalling Rs. 1,56,811 were received from Indian income-tax-free securities and were included in the fund in arriving at the net profits disclosed by this Company's actuarial valuation for the quinquennium ended 31st December 1930 and by that of its British Empire and Positive Funds for the quinquennium ended 31st December 1931:

Year.	Phoenix.	Year.	British Empire.	Positive.
	Rs.		Rs.	Rs.
1926	60,228	1927	27,104	600
1927	45,801	1928	330	600
1928	20,348	1929	Nil	600
1929	Nil	1930	Nil	600
1930	Nil	1931	Nil	600
	1,26,377		27,434	3000

Phoenix Assurance Company Limited.
Sd. T. P. Thomps
Actuary."

The Assistant Commissioner held that this certificate did not prove that any income from tax-free securities was included in the actuarial surplus. He therefore dismissed the claim. As regards the other point, *viz.*, that the Income Tax Officer erred in not giving credit for the actual amount of income tax

deducted at source to which according to the Company it was entitled under Sec. 18 (5) of the Indian Income Tax Act, the Company argued at the time of the hearing of the appeal that what they wanted was that credit should be given not of the average of the tax deducted during the quinquenniums but of the tax deducted during the previous year, *i.e.*, the year ended 31st December, 1933. But as has been stated above and as will appear from the "computed statement" reproduced above no such claim was made before the Income Tax Officer. There they claimed deduction of the average of tax deducted at source and they got what they claimed. For the reasons stated in the appeal order, the Assistant Commissioner did not allow this claim either. A copy of the appeal order will be found in Appendix "D."

7. In their application under Sec. 66 (2) for 1934-35 the Assessee Company formulated three questions as arising out of the appellate order. As I do not propose to refer any of these questions as formulated by the assessee, they need not be reproduced here. These questions, however, will be found in Appendix "E."

8. The questions of law that really arise out of the appellate order may be formulated as below:—

Question 1:—Whether when the income, profits and gains of a Life Assurance Company are arrived at for the purpose of charging income tax for any year, in the manner prescribed by rule 35 read with rule 25 of the rules made by the Central Board of Revenue in exercise of the powers conferred by Sec. 59 of the Indian Income Tax Act (Act XI of 1922) it is open to the assessee to go behind this notional figure by referring to the actual sources of its receipts and claim exemption from taxation in respect of any portion of the income.

Question 2:—Whether, when the income, profits and gains of a life Assurance Company are arrived at for the purpose and in the manner specified in question 11, and income tax is charged in respect of such amount, it is open to the assessee to go behind this notional figure and refer to the actual sources of its receipts in order to claim that a portion of the total income calculated represented income chargeable under the head "interest on securities."

Question 3:—Whether, when income tax for any year is charged in respect of income, profits and gains of a life Insurance Company computed in the manner prescribed by the rules referred to in question 1, the assessee can claim credit under Sec. 18 (5) of the Indian Income Tax Act, for any deductions of tax made at the sources.

Instead of referring the questions as framed by the assessee I beg to refer the above three questions only to the Hon'ble High Court and as required by Sec. 66 (2) of the Indian Income-tax Act I give below my own opinion thereon.

9. In my opinion when for the purpose of assessment of an Insurance Company its income, profits or gains are determined in the manner prescribed by the rules 25 to 35, it is not open to us to analyse the figure thus arrived at and determine the several elements constituting the total. It is indeed difficult thus to analyse the figure arrived at by the empirical method prescribed by rules. The question of determining the profit and loss of an Insurance Company is very complex and it was with a view to avoid all such complex calculations involved in the matter, that certain empirical rules were framed for assessment purposes. Whatever may be the reason why these empirical rules were so framed we have been given those rules and we are bound to apply them and them only for the purpose of finding out the total income of an insurance Company. For such a company therefore the total income becomes only a notional income and unless otherwise provided by these rules it is not open to us to introduce any dissection or analysis of this total. In my opinion in the case of an insurance Company, its income, profits and gains are not even classified under the heads referred to in Sec. 6 for determining the manner in which these are to be charged to income tax. Such manner of its chargeability is otherwise provided by the Act. Assessment of such a Company is specially provided for by these rules and it is to be remembered that Sec. 59 (5) makes them as effective as if enacted in the Act. Sec. 3 of the Income-tax Act, generally known as the charging Section, provides that while charging income tax for any year, it shall be charged in respect of all income, profits and gains of the previous year of the assessee. Section 2 (11) (b) defines the 'previous year' in the case of a company or class of company to be 'such period as may be determined by the Central Board of Revenue or by such authority as the Board may authorise in this qehalf.' Sec. 22 (1) requires that every Company shall furnish a return of the 'total income' of the Company during the previous year. Sec. 23 provides for assessment of this 'total income.' It may be pointed out that 'the previous year' does not necessarily mean the preceding year. It may be any other period and the Central Board of Revenue is given power to determine such a period. Whatever be the period that may be determined to be the previous year for a Company, it

must be remembered that assessment for any year does not mean assessment in respect of the income of that year, but assessment in respect of the income of the 'previous year'. Consequently if for example '1930' be determined to be the previous year of a Company for its assessment for 1934-35, the income which will have to be found out must be the income of the year 1930 and it is this income which will be assessed during 1934-35. This will no doubt be the arrear assessment. Indeed the scheme of the present Income-tax Act is one of arrear assessment. Only ordinarily one year's income is assessed during the next succeeding year. But while this is so ordinarily, it is not the general rule for all cases and it has already been pointed out how in cases of companies it is open to the Board to determine otherwise. In the case of an Insurance Company rules 25 to 35 determine this 'previous year' to be the average year of the preceding valuation period and rule 35 gives the special rule for computation of 'Total income' in case of a foreign insurance company. These rules, it has been pointed out, have been made in the exercise of power conferred by Sec. 59. Sec. 59 empowers the Board to make rules for carrying out the purpose of this Act and for ascertainment and determination of any class of income. In particular the Section empowers the Board by making rules to prescribe the manner in which, and the procedure by which the income, profits and gains shall be arrived at in the case of Insurance Companies. "The income, profits and gains" here in my opinion means 'the income, profits and gains' in respect of which income-tax is to be charged under Section 3. In exercise of this power conferred by Sec. 69 the Board has made several rules, of which rules 22 to 30, 32 and 35 relate to Insurance Companies. The one relevant for our present purpose is rule 35 which prescribes the manner in which the total income of the assessee company is to be determined. The assessee itself while submitting its return worked up the proportion referred to in the rule and the Income-tax Officer simply accepted his calculation of the assessee. The calculation made by the assessee for the purpose of this rule has already been given. It will appear therefrom that for the purpose of finding out the total income, profits or gains of the Company taken in all its branches, the assessee took the figures for the period of 5 years ending 31 December 1930. Thus the total income calculated for the Indian branch was really the average annual income of that branch during the period of 5 years ending 31st December 1930. This is the income in respect

of which income-tax has been charged for the year 1934-35. Remembering that the Central Board of Revenue can not only prescribe the manner in which income to be charged shall have to be calculated, but can also determine which year's income shall be charged during which year it seems obvious that by sanctioning the above method of determining the income to be charged for the year 1934 35, 'the previous year' for an insurance Company within the meaning of Section 3 becomes not the preceding year but a year of the preceding valuation period. If this view be correct then the average year of this valuation period becomes the only relevant year for the purpose of assessment for any year till the next valuation. To my mind this seems to be quite reasonable also. Ascertainment of income, profits and gains of an Insurance Company is always a difficult matter. Where therefore, there has been ascertainment of its profits by experts, the assessment may reasonably be directed to proceed on this expert calculation. Income of the valuation period is charged to income-tax by spreading it over another equally long period succeeding the valuation period. This makes the assessment quite reasonable and equitable. Otherwise if we take the previous year for an Insurance Company thus assessed to be the preceding year then for the assessment for 1934-35 we are to make assessment in respect of the income of year ended 31st December 1933. But in determining this income the rules take us to the average annual income of the period of 5 years ending 31st December 1930 and 31st December 1931. This will really be taking the average annual income of the valuation period to be the income assessable in 1934-35. Or in other words, while Section 3 requires that assessment must be in respect of income of the previous year, these rules while professing only to prescribe the manner of computation of the income will, as a matter of fact, require us to make assessment in respect of income of a different year. To my mind such an interpretation of the rules will render them '*ultra vires*' of the power conferred upon the Board by Section 59. I would therefore respectfully submit that these rules not only prescribe the manner of computation of the income but also determine 'the previous year' for an insurance company. As regards the determination of the assessable income the rule is empirical and helps us to arrive only at a 'notional figure' not necessarily the actual figure of any particular year. In my opinion this figure does not refer to any particular source or sources as contemplated by Sec. 6 of the Act

and does not admit of any dissection or analysis. The figure thus determined cannot be said to comprise income under one head or other as classified under Sec. 6. It is an empirically determined figure and represents only the total assessable income of the Insurance Company for its assessment for 1934-35. The figure of actuarial net profits is an item by itself and it has been directed in rule 25 that this will be held to be the Life Assurance business income. In this connection I would refer to the decision of the Lahore High Court in the case of the *Laxmi Insurance Company* (VI.T.C. 24). It has been held in that case that rule 25 of the rules made by the Central Board of Revenue under Sec. 59 (2) (a) is of a mandatory character and that it provides the only manner in which the income, profits and gains of Life Insurance Companies can be determined. It does not give any discretion to the assessing officer to depart from its provisions and to have recourse to the other provisions of the Income-tax Act for the purpose of determining and assessing the income, profits and gains of a Life Assurance Company. Sec. 10 of the Income-tax Act which provides for computation of business income (other than of Insurance Companies) will not therefore apply. These rules are intended to be self-contained provisions for assessment of insurance companies and to a case where these rules will apply the provisions contained in Secs. 6 to 12 shall have no application. That this is the intention of the law will be evident from rule 30 which provides for allowing depreciation on assets (otherwise allowable under Sec. 10) and losses which are not ordinarily allowed. Again in rule 25, there is provision for adding to the average annual net profits, the tax deducted from investments of the company during the valuation period. If the other provisions of the Act applied, this provision in rule 25 would be redundant for according to Sec. 18 (4) of the Act, the tax deducted at source is to be deemed to be income received. If the average annual net profits could be held as containing income from taxed securities the provision of Sec. 18 (4) would have been applicable to the portion of the income. It is because it is Life Assurance business income and not income from interest on securities or from dividends as one of its components that it has been necessary to make provisions for giving credit of income-tax deducted from interest on the investments of a company doing life assurance business. This has been provided for in rule 27. No part of the total income calculated in the manner provided by these rules can be said to represent any receipt by the Company which might not have been liable to

pay tax. The amount thus determined must be taken to be the amount in respect of the whole of which income-tax is chargeable. In my opinion therefore both questions 1 and 2 should be answered in the negative.

10. As regards the third question I beg to submit that Sec. 18 (5) of the Income-tax Act has no application to a case where the assessment is not made per different heads of income as specified in Sec. 6. It has already been pointed out how in making assessments of an Insurance Company, its assessable income is determined quite empirically and how the figure thus determined is taken as the 'total income' of the Company without any reference to the amount and sources of the receipt. Sec. 18, in my opinion, has no application to a case like this. That section applies only when an assessee is chargeable in respect of income under the heads 'salaries' and 'interest on securities.' In the case of the assessee Company there has been no assessment in respect of any such income. It has been assessed only in respect of a notional sum and it is not open to us to go behind this determined amount and examine the details of the calculation in order to discover which elements entered into this empirical calculation. In my opinion, therefore, this question should also be answered in the negative. It may be noticed here that in the above view of Sec. 18 (5) the allowance, even of the average deduction made by the Income tax Officer may be held to be untenable. Reference, however, may be made to rule 27 in this connection which seems amply to support the allowance made by the Income-tax Officer. The rule says that if the Indian income-tax deducted from interest on the investments of a company exceeds the tax on the income, profits and gains thus calculated, a refund may be permitted of the amount by which the deduction from interest on investments exceeds the tax payable on such income, profits or gains. The rule does not explicitly speak of allowing credit for such deductions and does not state the period during which the deductions referred to have been made. Sec. 18 (5) provides that when certain deductions at the sources are made, credit for the same must be given in the assessment made for the following year. Rule 27 says nothing about which year's deductions are to be credited against which year's income-tax. As, however, these rules are contemplating the valuation period and as the expression "income, profits and gains thus calculated", refers to the period of valuation and refers to the annual average of that period's income, it is fair to take the 'deductions' also as referring to that

period, and in the absence of any clear provision such deductions to be credited against annual average income should also be taken as annual average deduction. If this be correct, this is another reason why Section 18 (5) should not apply to these cases. For in that case credit for deductions made at sources during the valuation period shall have to be given under rule 27 and then deduction made during the preceding year also shall have to be credited under Section 18 (5) and this last item will again have to be credited during the next quinquennial period.

11. The following papers are submitted as Appendices :—

(1) Consolidated revenue accounts and valuation sheets	...	Appendix	A.
(2) Assessment order	...	,,	B.
(3) Grounds of appeal	...	,,	C.
(4) Appeal order	...	,,	D.
(5) The application under Section 66 (2)	...	,,	E.

W. JOHNSTON,

Commissioner of Income-tax, Bengal.

Isaacs, for the Assessees.

The Advocate-General, R. B. Pal and *R. C. Pal*, for the Commissioner of Income Tax.

JUDGMENT.

DERBYSHIRE, C.J.—The questions of law submitted in this case are identical with the first three questions submitted in the case of the North British and Mercantile Insurance Company which have been answered by me in the affirmative. The facts, however, in this case are somewhat different.

The Phoenix Assurance Company carries on business throughout the world as well as in India. In the return for which assessment was made for the year 1934-1935 the Company did not submit a balance-sheet dealing with its separate insurance activities in India, but submitted a statement purporting to be under rule 35 of the Rules made under Sec. 59 of the Income Tax Act, showing the total profits of the Company in respect of all its Life Assurance activities throughout the world, based on a quinquennial valuation for the five years ending December 31st, 1930 (A).

It also showed the total premiums received by the Company as a whole in respect of that period (C) and also the premiums received in India in respect of the same period (B). The profits of the Indian Company were then calculated to be B/C x A—Rs. 15,65,974, giving an average annual profit of the Life Assurance Business of Rs. 3,13,195. This purported to be in accordance with rule 35. The Company claimed that the said annual average net profits included an item of interest derived from tax-free securities of the Government of India and that in consequence of the proviso to Section 3 of the Income Tax Act, 1922, no income tax was payable on such item of tax-free interest. The Assistant Commissioner gave the Company an opportunity of proving that the average annual net profits included this item of tax-free interest and the Company submitted a certificate from its London Actuary to the following effect:

"I hereby certify that the undermentioned amounts of interest totalling Rs. 1,56,311 were received from Indian income-tax-free securities and were included in the fund in arriving at the net profits disclosed by this Company's actuarial valuation for the quinquennium ended 31st December, 1930, and by that of its British Empire and Positive Funds for the quinquennium ended 31st December, 1931."

[The British Empire and Positive Funds are the funds of subsidiary companies controlled by the Phœnix. The case throughout has been treated as if all the profits and tax-free interest were made and (or) received by the Phœnix Company during the quinquennium ending 31st December, 1930].

The Assistant Commissioner held that the certificate in question did not prove that any income from tax-free securities was included in the actuarial surplus and he dismissed the assessees' claim to have the above amount of tax-free interest deducted from the total profits and gains and so exempted from tax. Beyond the Actuary's certificate there is no proof that the tax-free interest in question is included in the actuarial surplus. The evidence was offered, however, in such a form as is usual in cases where various items go to make an aggregate income. If the Assistant Commissioner in this case was not satisfied with the evidence, he could have called for further evidence. He has not done that, but dismissed it forthwith. To prove a matter of this kind strictly in accordance with the rules of evidence might be a difficult matter, but if the Income Tax Authorities wish to have the matter strictly proved they should, in my opinion, give the

assessees a further opportunity of bringing proof. That was not done in this case.

The case was argued before us on the basis that the tax-free interest abovementioned was actually received by the Company in India, and that the Company's Indian income is simply the proportion of the Company's whole world-wide income that the Indian premiums bear to the world-wide premiums. If in fact the tax-free interest has been received by the Company, it must have gone into the funds of the Indian branch of the Company and then reckoned in the total of the world-wide funds of the Company. The only effect of this tax-free interest has been to increase the world-wide funds of the Company without increasing its liabilities. The tax-free interest has, therefore, contributed to the world-wide surplus and it seems to me that the Indian proportion B/C of the world-wide surplus must of necessity contain the same proportion B/C of the tax-free interest. I am of the opinion, therefore, that the assessees in this case, once they have satisfied the Income Tax authorities that they have received the interest on Government securities tax-free above mentioned, and that it has been reckoned in the world-wide funds of the Company, are entitled to have the same proportion of that tax-free interest that the Indian premiums bear to the world-wide premiums, deducted from the income, profits and gains assessed under rules 25 and 35 and exempted from tax.

The answers to questions (1), (2) and (3) are, for the reasons given in the case of the North British and Mercantile Insurance Company, in the affirmative, subject to what I have stated above.

The assessees are entitled to their costs in these proceedings.

Costello, J.—With regard to the case of the Phœnix Assurance Company, Limited, I agree with the judgment delivered by my Lord the Chief Justice and I do not think it necessary that I should add any words of my own.

Panckridge, J.—In my opinion, the answers which have been given to the questions propounded in the case of the North British and Mercantile Insurance Company, Limited, must be given to the same questions propounded in the case of the Phœnix Assurance Company, Limited.

Solicitors: *Sandersons & Morgans* for the Assessees; *R. C. Pal* for the Income Tax Authorities.

[IN THE PRIVY COUNCIL.]

COMMISSIONER OF INCOME-TAX, BOMBAY

v.

A. P. SWAMY GOMEDALLI.

LORD MACMILLAN, SIR SHADI LAL & SIR GEORGE RANKIN.

April 30, 1937.

HINDU UNDIVIDED FAMILY—SOLE SURVIVING MALE MEMBER—INCOME RECEIVED BY RIGHT OF SURVIVORSHIP—WHETHER ASSESSABLE TO SUPER-TAX AS INCOME OF INDIVIDUAL—'HINDU UNDIVIDED FAMILY', MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 3, 55.

Income received by right of survivorship by the sole surviving male member of a Hindu undivided family can be taxed in the hands of such male member as his own individual income for the purposes of assessment to super tax under Sec. 55 of the Indian Income Tax Act, 1922.

KALYANJI VITHAL DAS *v.* COMMISSIONER OF INCOME TAX, BENGAL (1937 I.T.R. 90) *followed.*

Appeal from a judgment of the Bombay High Court reported as *Commissioner of Income Tax, Bombay* v. *Gomedalli Lakshminarain* at p. 367 of Vol. IV of the *Income Tax Reports.*

For the facts of the case reference may be made to the judgment of the Bombay High Court above referred to.

A. M. Dunne, K. C. and *E. L. Norton*, for the Appellant.

L. De Gruyther, K. C. and *J. M. Parikh*, for the Respondent.

JUDGMENT.

LORD MACMILLAN.—Since the order pronounced by the High Court in the present case on March 28, 1935, this Board has had occasion to consider the interpretation of the words "Hindu undivided family" as employed in Sec. 55 of the Indian Income Tax Act, in the case of *Kalyanji Vithal Das* v. *Commissioner of Income Tax, Bengal,* in which the judgment of their Lordships was delivered on November 30, 1936. In that case the meaning of those words in the section in question, where they are

used in connection with liability to super-tax, was very fully examined in the judgment which Sir George Rankin prepared on behalf of the Board, and a conclusion was reached contrary to the view which the High Court has adopted in the present case. Mr. de Gruyther has sought to show that the principle of that decision does not apply to the facts of the case now before the Board. Their Lordships have listened attentively to Mr. de Gruyther's observations, but they are not satisfied that the facts of the present case differ in any material respect from the facts which were before the Board in the previous case in 1936, and the decision in that case must accordingly rule the present appeal.

Their Lordships will, therefore, humbly advise His Majesty that the appeal should be allowed, and the order of March 28, 1935, be reversed; that it should be found in answer to the first question as follows:—

"That in the circumstances of the case the income received by right of survivorship by the sole surviving male member of a Hindu undivided family can be taxed in the hands of such male member as his own individual income for the purposes of assessment to super-tax under Sec. 55 of the Indian Income Tax Act, 1922";

and that the answer to the second question should be in the affirmative.

The appellant will have his costs here and below.

Appeal allowed.

Solicitor for the Appellant:—*The Solicitor, India Office.*

Solicitors for the Respondent:—*Mr. Stanley Johnson and Allen.*

[IN THE CHIEF COURT OF OUDH].

COMMISSIONER OF INCOME TAX, U.P. and C.P.

v.

BEHARI LALL-RAMCHANDRA.

SRIVASTAVA, C. J., and SMITH, J.

May 7, 1937.

APPEAL—ADDITIONAL GROUNDS—MAY BE ENTERTAINED AT ANY TIME BEFORE APPEAL IS DECIDED—IMPROPER REJECTION—REFERENCE—QUESTION OF LAW—COMMISSIONER CANNOT MODIFY QUESTION WHICH HIGH COURT HAS DIRECTED HIM TO REFER—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 30 (2), 66 (3).

The view that additional grounds of appeal cannot be filed after the expiry of the period prescribed by Sec. 30 (2) of the Income Tax Act for filing an appeal is erroneous. Additional grounds may be filed by the appellant and entertained by the Assistant Commissioner in the exercise of his discretion at any time before the appeal is decided.

If the Assistant Commissioner has exercised his discretion in refusing to entertain additional grounds, in an improper manner, the discretion would be open to correction.

Under the Rules framed by the Oudh Chief Court, where the Chief Court has on the application of an assessee under Sec. 66 (3) required the Commissioner to state a case without making any modification in the form of the question of law stated in the application of the assessee, the Commissioner is bound to refer the question in the form set forth in the application of the assessee.

The technicalities in a fiscal statute must be strained in favour of the subject if they are to be strained at all and not against him.

Case referred to :

BALAKRISHAN NATHANI *v.* COMMISSIONER OF INCOME TAX, C.P. (1924) (A.I.R. 1924 Nag. 153; 78 I.C. 572; 1 I.T.C. 248).

Case stated by the Commissioner of Income Tax, U.P. and C.P., under Section 66 (3) of the Indian Income Tax Act (Civil Ref. No. 5 of 1936).

Kamalakant Varma for the Commissioner.

Ram Prasad Varma and *S. N. Nigam* for the Assessees.

JUDGMENT.

The facts and circumstances which have given rise to this reference under Sec. 66 (3) of the Indian Income-tax Act (XI of 1922) are briefly these.

The assessee is a firm of three partners. Lala Behari Lal, one of these partners, for the benefit of the firm obtained a contract for cutting and removing trees in the Mianpur forest for a consideration of Rs. 21,100. The Income Tax Officer of Sitapur served the assessee with a notice under Sec. 22 (2) requiring the firm to furnish a return of its income for 1931-32. The return which was filed in pursuance of this notice was not accepted and the assessee was required to produce the accounts. It was ultimately agreed between the assessee and the Income-tax Officer that the assessment may be made at a flat rate of 40 per cent. on

the purchase money of Rs. 21,100 distributed over a period of two years, during which the work of the contract was expected to be finished. The firm was accordingly assessed in the amount of Rs. 4,220 (40 per cent of Rs. 10,550 the assumed assessable income for 1931-32). The firm was assessed to income tax on the same amount for 1932-33. In the course of proceedings for assessment of income tax for the year 1934-35 against Lala Behari Lal in his personal capacity, the Income tax Officer discovered that Lala Behari Lal had realised Rs. 23,809 as the profits of the Mianpur forest contract relating to his 7 annas share in the firm. Thereupon the Income tax Officer served Lala Behari Lal on January 14, 1935, with a notice under Sec. 22 (2) for submission of a return of the income of the firm for the purpose of assessment for the year 1934-35. On the same date Lala Behari Lal filed a return on behalf of the assessee stating the income to be Rs. 45,981. We understand that this figure represented the income for the whole period of the contract. The return was not accepted, and the assessee was required to produce his accounts. After an examination of the accounts and consideration of evidence the Income tax Officer on February 5, 1935, assessed the firm to income tax for the year 1934-35, on an amount of Rs. 69,422. On March 2, the assessee filed an appeal to the Assistant Commissioner objecting to the amount of the assessment. During the pendency of the appeal, on July 25, 1935, the assessee filed an application urging certain additional grounds in support of the appeal. The main ground urged in this application was that under the income tax law the income once assessed could not be assessed again, and that the assessment for the years 1934-35 could be based only on the income of the previous year, and not on the income for the years 1930-31 and 1931-32, for which assessment had already been made. The Assistant Commissioner of Income Tax disposed of the appeal by his order dated July 31, 1935. After discussing the grounds raised in the original memorandum of appeal he proceeded to observe as follows :—

"I now consider the additional grounds of appeal which have been filed on July 25, 1935......I do not think, I can permit such additional grounds to be raised after the period described for the filing of the appeal had expired. I may, however, mention that the point raised in these additional grounds of appeal finds a very correct and convincing answer in the second ground of appeal that was originally filed. The ground of appeal is as follows :—

'Because the partnership business was in the shape of a running contract and the appellants during the pendency of contract were assessed on an estimated profit, as the final assessment could not be made until the forest timber was completely disposed of.'

It is clear from the ground of appeal quoted above that the assessee is conversant with the practice that is followed in assessing running contracts which are either assessed when the business is entirely closed or are assessed on estimated profits and a final assessment is made when the accounts are closed. I, however, decline to admit these additional grounds of appeal at this stage of the case."

As a result of his decision on the grounds raised in the original memorandum of appeal, he reduced the income liable to assessment to Rs. 40,982. Dissatisfied with this order the assessee made an application to the Commissioner of Income Tax under Sec. 66 (2) and Sec. 33 of the Indian Income Tax Act. The Commissioner declined to move under Sec. 33, and also refused to make a reference under Sec. 66 (2). With reference to the application which was made by the assessee on July 25, 1935, the learned Commissioner observed as follows:—

"The statutory limitation for filing an appeal is 30 days from the date of the receipt of notice of demand which was served on February 6, 1935, *i.e.*, on the very day the assessment was made. ......Then nearly five months after an application was made on July 25, 1935, for permission to introduce additional grounds challenging the validity of the assessment. For very adequate reasons, the Assistant Commissioner declined permission......for filing additional grounds. It is discretionary with an Assistant Commissioner to allow additional grounds to be filed or not and particularly when they are to be filed several months after the expiry of the statutory period for filing an appeal. No question of law arises out of the exercise of the unqualified discretion allowed to him."

Thereafter the assessee on December 2, 1935, made an application to this Court under Sec. 66 (3) praying that the Commissioner be requested to state the case on the following questions of law which arise out of the case......(C) Whether in the circumstances of the case the Assistant Commissioner was justified in declining to admit the additional grounds or evidence.

This application was heard by a Bench of this Court of which one of us was a member. The Bench was of opinion that the application raised questions of law which were deserving of further consideration, and, therefore, directed the Commissioner of

Income Tax to state a case and refer it to the Court under Sec. 66 of the Income-Tax Act. In obedience to this order the Commissioner has made the present reference. He has propounded the question of law forming the subject of the reference in the following words:—

"In the circumstances stated was it incumbent on the Assistant Commissioner to admit additional grounds of appeal filed by the Assessee?"

A preliminary objection has been raised on behalf of the Crown that a reference should not have been ordered under Sec. 66 (3) because there was no question of law arising out of the appellate order of the Assistant Commissioner under Sec. 31 of the Act. The same objection appears to have been faintly suggested by the Commissioner also in the case stated by him. As the order passed by the Bench of this Court requiring the Commissioner to refer the case to the Court was made without notice to the Crown, we have entertained the objection and heard the parties in respect of it. We are of opinion that the objection is without substance. As already stated, the Assistant Commissioner decided the appeal under Sec. 31 by his order dated July 31, 1935. In this order he discussed first of all the grounds mentioned in the memorandum of appeal. He then proceeded to consider the additional grounds of appeal, and disposed of them "in limine" on grounds the material portion of which we have quoted above. While on the one hand the Assistant Commissioner seems to have expressed the opinion that the additional grounds were without substance as a convincing answer to them was furnished by the second ground of appeal which was originally filed, he did at the same time decline to admit those grounds because they were raised after the period prescribed for the filing of the appeal has expired. Having carefully read the finding of the Assistant Commissioner in respect of these additional grounds, we are clearly of opinion that his order disposing of these grounds must be treated as an order under Sec. 31 of the Income Tax Act. We, therefore, overrule the preliminary objection.

An application has also been made by the assessee questioning the correctness of the form in which the question under reference has been worded by the Commissioner. We think the complaint made in the application is well-founded. This Court has framed rules of procedure for cases under Sec. 66 of the Indian Income Tax Act. These rules are to be found in Appendix VII of the Rules of the Chief Court. Rule 10 is as follows:—

"The statement of the case shall set out in the concluding paragraph thereof the point of law to be decided as stated in the application of the assessee, or any modified form thereof which the Chief Court may have ordered, together with the opinion of the Commissioner of Income Tax thereon."

As the Bench of this Court when requiring the Commissioner to make the reference had not made any modification in the form of the question as stated in the application of the assessee, the Commissioner was therefore bound under the rule set forth above to state the point of law in the form stated in the application of the assessee. We would accordingly substitute in place of the question as propounded by the Commissioner the question in the form stated by the assessee, which we have already quoted.

Turning now to the merits of the question, we would point out that the Income Tax Act is an Act complete in itself. Sec. 30 of the Act provides for an appeal against an assessment to the Assistant Commissioner. Sub-s. (3) of this section provides that the appeal shall be in the prescribed form, and shall be verified in the prescribed manner. The form of the appeal has been prescribed by Rule 21 of the rules framed by the Central Board of Revenue under Sec. 59 of the Act. It may be noted that O. XLI Rule 2 of the Code of Civil Procedure provides that the appellant shall not except by leave of the Court urge or be heard in support of any ground of objection not set forth in the memorandum of appeal. The object of this rule clearly is to give notice of the ground of objection to the opposite party. There is no such rule to be found in the Income Tax Act or in the rules framed under Sec. 59 of that Act. It may well be that there is not the same need for stringency in the case of appeals under the Income Tax Act, because there is no question of notice being given to any officer of the Crown, as we understand that the Crown is never represented by any officer at the hearing of appeals by the Assistant Commissioner. This consideration lends some support to the argument urged on behalf of the assessee that he could as a matter of right raise additional grounds at any time before the hearing of the appeal. Even if this is not so, we have no doubt that the Assistant Commissioner could admit the additional grounds in the exercise of his discretion. It is also a rule of general law that when a Court is allowed discretion in any matter, the discretion must be exercised in a judicial manner, and not capriciously or arbitrarily. It is also well-settled that the proper or improper exercise of discretion is a question of law. If, therefore, the

Assistant Commissioner has exercised his discretion in refusing to entertain the additional grounds in an improper manner, the discretion must be open to correction. We are inclined to think that the Assistant Commissioner exercised his discretion in refusing to admit the additional grounds of appeal mainly because he was of opinion that the application for filing additional grounds of appeal was governed by the 30 days' rule of limitation laid down in Sec. 30 (2) of the Act. We are definitely of opinion that this view is incorrect. In the present case the original appeal was admittedly filed within the prescribed period of limitation. The law does not contemplate two appeals against the same order. One appeal having already been filed, the application for the consideration of additional grounds of appeal cannot in any sense be regarded as an appeal governed by the rule of limitation laid down in Section 30. There is no rule of limitation prescribed for filing additional grounds. Such grounds date back to the date of the original appeal, of which when admitted, they become a part. The additional grounds of appeal can, therefore, be filed at any time before the appeal, is decided. The Assistant Commissioner was, therefore, quite wrong in holding that the additional grounds could not be allowed to be raised after the period prescribed for the filing of the appeal had expired. We would also note that the additional grounds were intended to question the principle on which the assessment had been based by the Income Tax Officer. The objection raised in these grounds went to the root of the assessment. The position of the Income-Tax authorities is a delicate and difficult one. They have to levy the tax and at the same time to decide judicially objections raised by assessees. In such circumstances it is their duty to act with the utmost fairness to the assessees so as to give them no ground for complaint. If an objection of this nature comes to their notice, they are expected to examine it fairly on its merits, and not to take refuge behind any technical defect in the manner in which the objection is raised In *Balakrishna Nathani* v. *Commissioner of Income Tax* it was held that technicalities in a fiscal statute must be strained in favour of the subject if they are to be strained at all, and not against him. Thus, taking into consideration all the circumstances of the case and particularly the serious and important nature of the objections which were sought to be raised against the principle of assessment adopted by the Income Tax Officer, we are of opinion that the Assistant Commissioner exercised his discretion erroneously and in an improper manner in declining to admit the additional

grounds of appeal. We would answer the question forming the subject of the reference accordingly. The assessee applicant will get his cost from the opposite party under Rule 12 of the Rules of the Court. We fix the Pleaders' fee payable to the assessee at Rs. 400 and the fee payable to the Counsel for the opposite party at the same amount.

Order accordingly.

[IN THE MADRAS HIGH COURT]

NEELAMEGHAM PILLAI

v.

SECRETARY OF STATE FOR INDIA.

VARADACHARIAR AND PANDRANG ROW, JJ.

April 5, 1937.

INCOME TAX OFFICER—DISMISSAL BY COMMISSIONER—SUIT FOR DAMAGES—MAINTAINABILITY—JURISDICTION OF CIVIL COURTS —WANT OF PREVIOUS APPROVAL OF GOVERNMENT AND FAILURE TO FOLLOW PROCEDURE PRESCRIBED BY RULES, EFFECT OF— INDIAN INCOME TAX ACT (XI OF 1922), SECTION 5—GOVERNMENT OF INDIA ACT, 1919, SECTION 96-B.

A Civil Court is not competent to give redress to a dismissed Income Tax Officer even though the procedure prescribed by the Civil Service Classification Rules had not been followed by the Commissioner before dismissing him.

An order of a Commissioner dismissing an Income Tax Officer is not invalid merely because it was not made with the previous approval of the Local Government, inasmuch as the Rules contemplate previous approval of the Government only in the matter of appointment *of such officers and give a right of appeal to the Government against an order of dismissal.*

Under Sec. 5 of the Income Tax Act, in the matter of the appointment of Assistant Commissioners and Income Tax Officers the Commissioner of Income Tax is the appointing authority, though by way of appeal or by way of veto or even by an executive rule as to previous approval his exercise of the power may be subject to interference by the Governor-General in Council or the Governor in Council. The Commissioner is, therefore, not an authority subordinate to the appointing authority within the meaning of Sec. 96-B of the Government of India Act. Similarly in the case of dismissals the

rules contemplate that dismissal is to be by the Commissioner and not by the Governor in Council.

Cases referred to :

VENKATA RAO *v.* SECRETARY OF STATE FOR INDIA [1937] (64 I.A. 55).

RANGACHARI *v.* SECRETARY OF STATE FOR INDIA [1937] (A.I.R. 1937 P.C. 27).

Appeal [No. 559 of 1930] against the Decree of the court of the Additional Subordinate Judge of Trichinopoly.

This appeal coming for hearing the court delivered the following

JUDGMENT

VARADACHARIAR, J.—The appellant who had been appointed Income Tax Officer in June 1922 was dismissed from service by an order of the Commissioner, dated 22nd June 1925. He filed this suit for damages, contending that this order of dismissal was illegal, void and *ultra vires*.

The validity of the order was challenged on two grounds (1) that the Commissioner did not hold a proper enquiry before passing the order of dismissal and (ii) that in view of the provisions of Sec. 96-B of the Government of India Act, 1919, the Commissioner was not competent to pass the order of dismissal. Before the lower court, the first of the above contentions was advanced on the assumption that the plaintiff could have been dismissed only after enquiry in the manner prescribed by Rule 14 of the Civil Service Classification Rules. The learned Subordinate Judge was of opinion that that rule was not applicable to persons appointed under the Income Tax Act of 1922. This question has now become immaterial, because, even assuming that the procedure prescribed by that rule or any other rule has not been followed, a Civil Court is not competent to give redress to a person on that ground, after the decision of the Privy Council in *Venkata Rao* v. *Secretary of State for India*. An argument was urged before us, on behalf of the appellant, that in that decision as well as in the connected case, their Lordships were only dealing with the nature of the tenure, on which Civil Servants in India hold their office and did not decide the question as to the cause of action available to a Civil Servant on the ground that in the matter of his dismissal the prescribed procedure had not been followed. We are unable to agree with that contention. The first question dealt with by them was no doubt the nature of the tenure; but having arrived at the conclusion that Civil Servants in this country

hold their office at the pleasure of the Crown, their Lordships next did address themselves to the question of the effect of the reference in the opening part of Section 96-B to the *rules* made thereunder as qualifying the declaration of the tenure of the office. It is in dealing with this argument, that their Lordships say that while a solemn duty is laid upon the Government to observe these rules when dealing with the matter of the dismissal of an officer, the failure to do so will nevertheless not furnish a cause of action for a Civil Suit.

It was also contended before us, on the strength of a passage in Mr. Sundaram's book on the *Law of Income-tax*, that the commissioner is subject to the control of the Local Government as much in the matter of dismissing an Income-tax Officer as in the matter of appointing one. It was accordingly suggested that as the dismissal in this case did not appear to have been made with the previous approval of the Local Government, the dismissal was void in law. We propose to deal at some length with a cognate argument when dealing with the next contention of the appellant. We may, however, observe here that in the Devolution Rules specific provision has been made in this connection only in respect of the *appointment* of Assistant Commissioners and Income Tax officers delegating the power of the Governor-General in Council in that behalf under sec. 5 of the Income tax Act, to the Governor in Council. The only specific reference to the question of dismissal, in the Devolution Rules is by way of giving a right of appeal to the Governor-General in Council (formerly to the Governor in Council) to any Assistant Commissioner or Income-tax Officer who has been dismissed or removed from office by the Commissioner. The reference to a right of *appeal* is a clear indication that it could not have been contemplated that the dismissal should be with prior approval obtained from the same authority: it is only in respect of 'appointment' that *previous* approval is referred to in the Devolution Rules.

In dealing with the second contention, urged on behalf of the appellant we are prepared to assume that the appellant, may, in view of the judgment of the Judicial Committee in *Rangachari's case* be entitled to some relief, if it could be said that the Commissioner who dismissed the appellant is within the meaning of Sec. 96-B of the Government of India Act, an authority "subordinate to that, by which he (the appellant) was appointed". The determination of this question turns on the construction of Sec. 5 of the Income-tax Act, 1922. It is there provided that

Assistant Commissioners and Income Tax Officers shall subject to the control of the Governor-General in Council, be appointed by the Commissioner of Income-tax by order in writing. The natural meaning of the words used seems to us to be that the Commissioner of Income Tax is the appointing authority, though by way of appeal or by way of veto or even by an executive rule as to previous approval, his exercise of this power may be subject to interference by the Governor-General in Council. Under rules framed under Sec. 45-A of the Government of India Act, the control of the Governor-General in Council (provided for in Sec. 5 of the Income Tax Act) has been delegated to the Local Government by the following Rule :—

"The Governor-General in Council desires to utilise the agency of the Governor in Council of each Governor's Province in the following matters only in relation to income tax:

(1) The appointment by a Commissioner of Income-tax of any person to the substantive post of Assistant Commissioner or Income-tax Officer shall be subject to the previous approval of the Governor in Council".

It has been contended on behalf of the appellant, that the appointing authority in the case of Income-tax Officers is not the Commissioner of Income-tax but either the Governor-General in Council or the Governor in Council and that therefore the Commissioner is a person subordinate to the appointing authority (within the meaning of Sec. 96-B of the Government of India Act). We are not able to accede to this contention. The language of Sec. 5 of the Income Tax Act as well as the language of the Devolution Rules is consistent only with the view that the Commissioner is the appointing authority, though, as already indicated, his powers in that connection may be interfered with by higher authority on various grounds. As regards dismissal, there is no specific section or rule providing for dismissal but, as we have already observed, the rule which gives a right of appeal against orders of dismissal formerly to the Governor in Council and now to the Governor-General in-Council proceeds on the assumption that the dismissal of an Income Tax Officer is to be *by* the Commissioner of Income Tax.

Both the grounds urged in support of the appeal accordingly fail and the appeal must be dismissed with costs. The Court fee payable on the memorandum of appeal shall be paid out of the estate of the deceased appellant if any, in the hands of the next friend.

Appeal dismissed with costs.

[In the Privy Council].

COMMISSIONER OF INCOME TAX, MADRAS.

v.

B. J. FLETCHER.

Lord Maugham, Sir Lancelot Sanderson and Sir George Lowndes.

June 14, 1937.

Salaries—Employees' Retiring Fund—Sum Allotted Periodically to Credit of Employees and Paid in Lump on Retirement—Whether Accumulation of Salary or Voluntary Payment—Assessability—Construction of Rules of Fund—Income and Capital—Indian Income Tax Act (XI of 1922), Section 4 (3) (*v*), Scope of.

The assessee who was an employee of a company was paid a monthly salary with half-yearly bonus, both of which were taxed in the ordinary course. He retired in 1933 and became entitled to receive from the company a sum of Rs. 36, 794 which stood to his credit on the date of his retirement in a fund called the "Officers' Retiring Fund" which the company had constituted for the benefit of its employees. Under the rules which regulated the constitution and management of this fund each half-year a certain sum called bonus was allotted by the company to the credit of this fund and this sum was invested and accumulated at the discretion of the directors. This half-yearly allotment was divided amongst the several officers of the company who were eligible to the benefit of the fund in proportion to their salaries and credited half-yearly in the accounts maintained in the names of the several officers, and each officer was given a pass book in which the amounts so credited to his account were entered. The High Court of Madras (Cornish and Pandrang Row, JJ.—Beasley, C. J., *dissenting*) *held that the contributions made by the company to the credit of its officers in the fund was not part of the officers' salary nor gratuity or profit received in lieu of or in addition to salary, but the sum in question was paid in lieu of pension, i e., in consideration of past services and being in the nature of a capital receipt was not taxable. On appeal to the Privy Council by the Commissioner of Income Tax:*

Held, *that the question whether the sum of Rs. 36,794 was taxable as deferred income or was a capital receipt depended mainly on the constitution of the fund. In view of the following facts, namely,*

that the sums to be allotted were entirely at the discretion of the company, that they were not bound to make any allotment in any year, that it was not part of the employee's original contract of service that he should have the benefit of this fund, that unless the company chose to put him on the list the employee would have no interest whatever in it, that even when so listed he would have no right until he had served for six years and that in no case could he make any claim upon the sums allotted to him until he retired, the allotments made to the fund in the name of the assessee were not in the nature of salary for current services but were merely the measure of a sum which the company volunteered to pay to him on the termination of his service; and though the payment of the lump sum was not within the specific exemptions of Sec. 4 (3) (v) of the Income Tax Act it was just as much a capital receipt in the hands of the assessee as would be the payment of a lump sum from a provident fund on the assessee's retirement. Such a payment was, apart from the specific exemption in Sec. 4 (3) (v), by its nature, capital and not income.

Obiter: *A lump sum paid in lieu of pension where no pension is payable is not the same thing as the commutation of a pension already earned and does not fall within the exemption of Sec. 4 (3) (v).*

Cases referred to:

COMMISSIONER OF INCOME TAX, BENGAL *v.* SHAW WALLACE & Co. (1932) (59 I.A. 206; 59 Cal. 1343; 136 I.C. 742; 6 I.T.C. 148; A.I.R. 1932 P.C. 138; 36 C.W.N. 653) referred to.

Appeal against the judgment of Beasley, C.J., Cornish and Pandrang Row, JJ., dated April 24, 1935, reported as *Commissioner of Income Tax, Madras* v. *B. J. Fletcher* (1935 I.T.R. 223).

Millard Tucker, K. C. and *Wallach,* for the appellants.

R. W. Needham, K. C. and *F. H. Talbot,* for the Respondents.

SIR GEORGE LOWNDES.—The question for determination in this appeal lies in a small compass but it involves a question of considerable nicety under the provisions of the Indian Income-tax Law. It is in effect, whether a sum of money payable to the respondent on his retirement after long service with an Indian Company is taxable as part of his income of the year in which his retirement took place. The learned Judges in the Madras High Court by whom the case was heard have—not unreasonably, as their Lordships think—differed in their conclusions and in the reasoning upon which those conclusions were arrived at.

The facts may be stated shortly. The respondent was an employee of the Buckingham and Carnatic Company, Ltd., and was paid a monthly salary with a half-yearly bonus, both of which were taxed in the ordinary course, and his liability in this respect was not challenged. He retired in February 1933, and was then entitled to receive from the company a sum of Rs. 36,794 which stood to his credit at that date in a fund called "The Officers' Retiring Fund." It is with this sum that the present appeal is concerned.

The fund was constituted and managed by the company under the following rules—

"All bonuses which the Company may from time to time allot to credit of this Fund shall be invested and accumulated at the discretion of the Directors. All interest accruing on the fund shall be dealt with in the manner provided in the next rule and as if such interest was a bonus allotted by the Company.

Every bonus shall, in the first instance, be apportioned as between the officers of the Company for the time being in proportion to the salaries drawn by them respectively at the date of the allotment of such bonus by the Company and shall be credited in such proportions to such officers in account with the fund. Provided always that no officer shall have any claim against the Company in respect of any bonus or otherwise as regarding this fund until he leaves the service of the Company and shall have previously served the Company continuously and satisfactorily for the period required of him under these rules.

The period of such service shall as regards all officers who shall have come out from England to join the service of the Company be six consecutive years and shall in the case of officers who have been engaged by the Company in India or any place east of Suez be ten consecutive years. Provided always that the Directors may in their discretion vary such latter period of ten years to one of six years.

On any officer who shall have served the Company for the full consecutive period required of him by these rules leaving the service of the Company, the Company will pay to him the aggregate amount of his share in the various bonuses that may have been credited to the fund by the Company, during the period of his service with the Company.

In the event of the death of any officer during, or after having completed, the said term of service, the shares standing to the credit of the deceased shall be paid to his legal representative.

In the event of any officer leaving the service of the Company or being dismissed before having completed the term of service hereby required, the sums standing to his credit shall be apportioned to the credit of other officers then in the employ of the Company in the same way as if such sums were a bonus allotted by the Company.

Nothing herein contained shall in any way be taken as restricting the powers of the Company, from at any time dispensing with the services of, or dismissing any officer, and any officer whose services shall be dispensed with, or who shall be dismissed before the full period of service required of him under these rules shall have no claim whatsoever against the fund.

The Directors of the Company for the time being shall have full discretion as to which of the officers or employees of the Company shall from time to time be eligible for the benefit of this fund, and as to any alteration or addition to these rules and the decision of the Directors on such points and as to the meaning of these rules, and on all other matters in any way connected with the fund or the administration of same shall be final and conclusive."

The rules were apparently communicated to the employees, and those who were placed upon the fund were given "pass books" in which were entered the amounts credited to them from time to time under the rules. Their Lordships think that the effect of this procedure was to create a trust in their favour which each of them could enforce upon fulfilment of the conditions by which his interests were bound, and it is not disputed that the respondent was so entitled. But their Lordships do not think the equitable nature of the respondent's claim affects in any way the question now in issue.

On the respondent's retirement the company, acting under Sec. 18 (2) of the Income-tax Act, 1922, deducted from the Rs. 36,794, which the assessor claimed to be part of his salary, the appropriate tax, and presumably passed it on to the Government. The respondent claimed a refund but this was refused, and after the usual departmental references the matter came up to the High Court under Sec. 66 (2) of the Act.

The question referred for the Court's determination was whether the sum of Rs. 36,794 paid to the respondents in 1932-33 was income liable to tax or was a capital sum exempted under the Sec. 4 (3) (*v*) of the Act or otherwise. The reference also covered

another question which is not material to the present appeal and has not been discussed before the Board.

Section 4 (3) (*v*) is in the following terms:—

"Any capital sum received in commutation of the whole or a portion of a pension or in the nature of consolidated compensation for death or injuries, or in payment of any insurance policies or as the accumulated balance at the credit of a subscriber to any such provident fund."

The reference was heard by the Chief Justice sitting with Cornish and Pandrang Row, JJ. Separate judgments were delivered by each of them.

The learned Chief Justice held that the respondent was rightly assessed upon the sum in question. He was of opinion that the case could not be brought within the exemption referred to by the Commissioner; that the allotments made to the respondent from time to time, which resulted in the total sum of Rs. 36,794, were made for current services, and so were a part of his regular remuneration; that the sum in question was not a gift or an act of grace on the part of the company or in the nature of a windfall, but that it was in reality payment of deferred salary and therefore, taxable in the year in which it was paid.

Cornish, J., took the opposite view. He thought that the nature of the fund from which the payment was made showed that it was not part of the respondent's "salary" but that it was a lump sum paid on retirement, in its nature indistinguishable from a similar sum paid under a provident fund which, apart from its specific exemption under the Act, could not, in accordance with the judgment in *Commissioner of Income Tax* v. *Shaw Wallace & Co.*, be regarded as income.

Pandrang Row, J., came to the same conclusion as Cornish, J., but on somewhat different reasoning. He thought that the payment was made by the company not as employer but as trustee and that this was in itself sufficient, apparently, to take it out of the category of salary—a view with which their Lordships are unable to concur. He also held that it was a lump sum payment *in lieu* of a pension, and, therefore, equivalent to a pension commutation which is specifically exempted under Sec. 4 (3) (*v*).

The question referred by the Commissioner was, in accordance with the opinion of the majority of the Court, answered in favour of the respondent. The present appellant, the Commissioner of Income-tax, was, by Order in Council dated April 30, 1936, granted special leave to appeal upon the condition that he

paid in any event the costs of the respondent as between solicitor and client.

Before their Lordships it has been contended that the sum in question is taxable under the head "salaries" which by Sec. 7 (1) of the Act includes any profits received by an assessee in addition to his salary, and the judgment of the Chief Justice is supported on this ground. Their Lordships have also been invited to consider the corresponding provisions of the law in this country and the cases decided thereunder, special reliance being placed on the judgments of the Court of Appeal in *Foster's case.* Their Lordships are, however, unwilling to embark on a critical comparison of two Acts, which admittedly differ widely in their scope and details; this has been laid down in a previous judgment of the Board (see *Commissioner of Income Tax, Bengal* v. *Shaw Wallace & Co.*) and their Lordships see no reason to adopt a different course in the present case.

Assuming that the sum in question was a "profit" arising from the respondent's employment, the question still remains whether it was received by him as income or was in the nature of capital. If it represented merely the payment of accumulated portions of a salary held up by the employers until the employee's retirement, it would, their Lordships think, be received by him as deferred income and, therefore, be taxable, and it is on this question that the decision of the case must turn. Their Lordships have no doubt that the answer must depend mainly on the constitution of the fund. The first point that emerges from an examination of the rules set out above is that the sums to be allotted were entirely in the discretion of the company. They were not bound to make any allotment in any year, and it was only if an allotment was in fact made that the officer concerned could have any claim. This of itself tends to negative the idea that the allotments were part of the officer's current salary. Nor is it suggested that it was part of the respondent's original contract of service that he should have the benefit of this fund; and unless the company chose to put him on the list he would have no interest whatever in it. Even when so listed he would have no rights until he had served continuously and satisfactorily for a period of six years. And in no case could he make any claim upon the sums allotted to him until he retired. If he died before retirement the payment of his share would be made to his legal representative, and the appellant's Counsel concedes that in that event no tax

would be payable. The consideration of these factors leads their Lordships to the conclusion that the allotments made to the fund in the name of an officer of the company were not in the nature of salary for current services, but were merely the measure of a sum which the company volunteered to pay to him on the termination of his service, and that this sum, when paid, was not "*income*" and, therefore, not taxable.

The company did not pension its officers, but in lieu of doing so, and no doubt with the object of keeping deserving employees in its service, it promised such persons a lump sum on retirement to be computed on terms formulated by the rules of the fund.

This was not, their Lordships think, within the specific exemptions of Sec. 4 (3) (*v*), and they are unable to accept the dictum of Pandrang Row, J., that a lum sum in lieu of a pension, where no pension is payable, is the same thing as the commutation of a pension already earned, and, therefore, within the words of the exemption. But they agree with Cornish, J., in thinking that such a payment is just as much a capital receipt in the hands of an employee as would be the payment of a lump sum from a provident found on the employee's retirement. The latter would, apart from the specific exemption in the clause under consideration, be by its nature, capital and not income; (see *Shaw Wallace's case supra* at p. 214), and it follows that the sum now in question must be treated in the same way.

For the reasons given above their Lordships will humbly advise His Majesty that the first of the two questions submitted to the High Court should be answered as follows :—"The sum of Rs. 36,794 payable to the respondent out of " The Officers' Retiring Fund " in 1933 was not income liable to tax," and that the appeal should be dismissed.

The order for costs will follow the terms of the Order in Council of April 30, 1936.

Appeal dismissed.

Solicitor for the Appellant :—*The Solicitor, India Office.*

Solicitors for the Respondents :—Messrs. *Percy Short & Cuthbert.*

[IN THE MADRAS HIGH COURT.]

THE COMMISSIONER OF INCOME TAX, MADRAS.

v.

Diwan Bahadar S. L. MATHIAS.

SIR H. O. C. BEASLEY, C. J., VARADACHARIAR, J., and KING, J.

April, 29, 1937.

AGRICULTURAL INCOME—COFFEE GROWN IN NATIVE STATE—CURED AND SOLD IN BRITISH INDIA—WHETHER EXEMPT FROM TAX—AGRICULTURAL INCOME—WHETHER ACCRUES WHERE PRODUCE IS RECEIVED IN KIND OR WHERE IT IS SOLD—CURING OF COFFEE, WHETHER 'MANUFACTURE' OR AGRICULTURAL PROCESS——INDIAN INCOME TAX ACT (XI OF 1922), SECS. 2 (1) (b) (ii), 4 (1) AND (2) & PROVISO TO SEC. 4 (2).

The assessee who resided in British India owned coffee plantations in the Mysore State. The harvested crops were brought to Mangalore (in British India) in their raw state to be dried and cured there in the factories of the selling agents of the company and were sold there by the agents. The sale proceeds were received and retained by the assessee at Mangalore. The question for determination being whether the whole or any part of the income derived by the assessee from the produce of his coffee estates in Mysore was exempt from taxation under the second proviso to clause (2) of Sec. 4 of the Indian Income Tax Act : Held, *that the income in question 'accrued or arose' in Mysore without British India where the produce was received in kind and was 'received or brought into British India' within the meaning of Sec. 4, Cl. (2), of the Indian Income Tax Act, and was therefore exempt from tax in British India under the second proviso to the said clause.* Held further, *that in the case of coffee the processes subsequent to picking the beans are not in the nature of 'manufacture' but only processes 'ordinarily employed by the cultivator to render the produce fit to be taken to the market' within Sec. 2 (1) (b) (ii), and the assessee was therefore entitled to exemption in respect of the whole of the price realised by the sale of the coffee.*

Receipt of produce in kind *may well be spoken of as receipt or accrual of income at the place where the produce is received and income from agriculture accrues or arises as soon as the agricultural produce is received in kind and not merely when the produce is sold and converted into money.*

Clauses (1) and (2) of Sec. 4 of the Indian Income Tax Act are not mutually exclusive. The first clause comprises receipts falling under the second clause as well.

Mohanpura Tea Co., In re, (1937 I.T.R. 188) dissented from; *Commissioners of Taxation* v. *Kirk* (1900 A.C. 588) explained and applied.

Cases referred to:

BACK *v.* DANIELS (1924) (1924, 2 K.B. 432) on appeal (1925) (1 K.B. 526; 9 Tax Cas. 183; 94 L.J.K.B. 101; 132 L.T. 455; 41 T.L.R. 162).

COMMISSIONER OF INCOME TAX, BIHAR & ORISSA *v.* MAHARAJA SIR KAMESHWAR SINGH (1933) (12 Pat. 318; 60 I A. 146; 37 C.W.N. 598; 1933 I.T.R. 94; 6 I.T.C. 401).

COMMISSIONER OF INCOME TAX, BENGAL *v.* SHAW WALLACE & Co. (1932) (59 Cal. 1343; 59 I.A. 206; 36 C.W.N. 653; A.I.R. 1933 P.C. 145; 63 M.L.J. 124; 136 I.C. 742; 6 I.T.C. 178).

COMMISSIONERS OF TAXATION *v.* KIRK (1900) (1900 A.C. 588).

JIWANDAS *v.* COMMISSIONER OF INCOME TAX, PUNJAB (1929) (4 I.T.C. 40; 10 Lah. 657; A.I.R. 1929 Lah. 609).

KILLING VALLEY TEA CO. LTD. *v.* SECRETARY OF STATE (1920) (48 Cal. 161; 61 I.C. 107; 1 I.T.C. 54).

MOHANPURA TEA CO., *In re* [1937] (1937 I.T.R. 188).

PONDICHERRY RY. CO. CASE (1931) (54 Mad. 691; 58 I.A. 239; 5 I.T.C. 363).

PORT SAID SALT ASSOCIATION, *In re* (1932) (59 Cal. 1226; 36 C.W.N. 563; A.I.R. 1932 Cal. 626).

PONNUSWAMI PILLAI, *In re* (1928) (3 I.T.C. 378).

SULLY *v.* ATTORNEY GENERAL (1860) (2 Tax Cas. 149).

Case stated by the Commissioner of Income Tax, Madras, under Sec. 66 (2) of the Indian Income Tax Act, 1922 [O.P. No. 181 of 1936].

STATEMENT OF CASE.

"I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Sec. 66 (2) of the Indian Income Tax Act (hereinafter referred to as the Act).

2. The petitioner is a resident of Mangalore and is assessed by the Income Tax Officer, Mangalore. He derives income from property, business and other sources.

3. The case arises out of the inclusion in the assessment made on the petitioner for the year 1934-35 (previous year, year

ended 30th April 1933) of a sum of Rs. 25,963 which the Income Tax Officer held to be the petitioner's profits of a coffee business carried on at Mangalore. The facts relating to this are the following:—

The petitioner owns two coffee estates in the Mysore State for which he pays land tax to that State. These estates are worked by the petitioner. He employs the labour required for the purpose and maintains an office in the estate in order to supervise them. The labour is recruited mainly at Mangalore, and the manure, spray materials, tools, crop-bags etc., required for the estate are purchased by the petitioner at Mangalore and are sent to the estate. The crops are harvested by the labour employed by the petitioner and are then brought to Mangalore in their raw state. There is no ready market for raw coffee. The petitioner gets the green coffee cured at Mangalore by persons owning curing factories, on payment of a commission to them. The cured coffee is insured against fire till sale and the petitioner pays the insurance charges. It is then sold at Mangalore by the petitioner's selling agents, Messrs. Pierce Leslie & Co., Ltd. and the sale proceeds are realised and retained there. A separate staff is maintained at Karkal in the Manglore District for the various operations conducted in Mangalore. The accounts are written up by the estate staff in Mysore in respect of the expenses incurred in Mysore, and by the Karkal staff in respect of the expenses incurred in Mangalore and in respect of the receipts. All the operations connected with the cultivation of the coffee plants and the collection, transport and sale of produce are controlled by the petitioner from Mangalore. The result of the accounts in Mysore is incorporated in the books maintained at Karkal and a consolidated Profit and Loss account is made there. The income from this source was assessed under the head 'business' in the past. The following is an abstract of the Profit and Loss account for the 'previous year.'

Sale proceeds at Mangalore *less* value of Opening Stock			... Rs. 1,22,354
Deduct expenditure	British India Rs.	Mysore Rs.	
Labour charges, purchase of manure, tools, straw, transportation charges, Mysore land tax, etc.	29,179	35,954	

Establishment charges and Stationery.	8,369	6,965	
Curing, selling, fire insurance subscription, subscription to trade association etc.	7,738	...	
Depreciation claimed	...	3,377	
	45,286	46,296	
			91,582.
	Balance		30,722
Interest on borrowed capital	10,753		
Less inadmissible expenses added back	5,944		4,809
Net profit determined by Income Tax Officer			25,963

There is no dispute regarding the figures. The petitioner contended that he was not conducting any business in coffee and that the income derived from green coffee brought from his estate in the Mysore State was exempt from assessment under the second proviso to Sec. 4 (2) of the Act. The Income Tax Officer over-ruled these contentions and held that the income obtained by the sale at Mangalore of the green coffee cured at Mangalore constituted income from business assessable under Sec. 4 (1) of the Act and that therefore Sec. 4 (2) including its second proviso did not apply.

He accordingly included the said income (Rs. 25,963) in the petitioner's assessment and adding the income under other heads assessed the petitioner on a total income computed at Rs. 29,160

4. The petitioner appealed to the Assistant Commissioner and contended, among other things which are not relevant for the purposes of this reference—

(1) that the income from the coffee estate was exempt under the proviso to Sec. 4 (2) of the Act, and

(2) that if any income was assessable under Sec. 4 (1) it was only the residue left out of the sale proceeds after deducting the market value of the green coffee and the curing and other charges.

The Assistant Commissioner overruled these contentions for the reasons set out in his order, an extract from which is filed, marked Exhibit A.

5. The petitioner now requires me to refer to the High Court 4 questions marked (1) to (4) in the application alleged to be questions of law arising out of the Assistant Commissioner's order. The petitioner's Advocate does not press questions (3) and (4) and I consider that questions (1) and (2) may be re-framed as below :

" Whether any part of the income derived by the petitioner from the produce of his coffee estates in Mysore is exempt from taxation under the second proviso to Sec. 4 (2) of the Indian Income Tax Act as being income that has accrued or arisen outside British India ".

The petitioner's Advocate agrees to the question as re-framed and I accordingly refer the above question for the decision of the Court.

6. In my opinion Sec. 4 (2) and its provisos have no application to the facts of this case. The sub-section renders liable to the tax income, profits or gains accruing and arising without British India, if they are received in or brought into British India. The second proviso creates an exemption from this liability and from no other. Such profit as the petitioner in this case derives from his possession of land in Mysore is derived by means of a business ; and the fact that agricultural operations form an element in the business does not render it any the less a business. So far as this point is concerned the case is covered by the decision of this court in the case of *Ponnusami Pillai* (3 Income Tax Cases 348). It was laid down in that judgment, that the business, including the agricultural processes, must be regarded as one whole (Cf. on this point 8 Tax Cases at p. 204). The agricultural processes, are not in themselves a source of income; they are merely an element in the business which produces the income. In order that the petitioner may bring himself within the exemption which he claims it is necessary for him to show that the profits of his business have accrued and arisen outside British India. I submit that he cannot do so. Not only does he reside in British India and there control the operations of his business, but those operations themselves, apart from the actual growth of the raw coffee, are performed in British India. When the raw materials of a business are procured by purchase, it has been held by this court that no profit arises from the fact of purchase (1 Income Tax Cases 194) and that

"a trade is exercised in the place where the sales are effected and the profit thereby realised" (at p. 200). I submit that the same principles apply where the raw materials are not purchased but grown. On the facts of this case, the place where the profits of his business "come home to" the petitioner is Mangalore in British India. That is his place of trade, and the place where his profits accrue and arise. I submit therefore that income which is the subject of this reference has not accrued or arisen without British India and cannot be brought within the scope of the second proviso to Sec. 4 (2)."

Patanjali Sastri for the Commissioner.

T. R. Venkatarama Sastri for *M. Subbaroya Ayyar* for the Assessee.

JUDGMENT.

The question referred to this court for decision is whether on the facts set out in the Commissioner's statement, any part of the income derived by the assessee from the produce of his coffee estates in Mysore is exempt from taxation under the second proviso to clause (2) of Sec. 4 of the Indian Income Tax Act.

The assessee who owns coffee plantations in the Mysore State is a resident of British India (Mangalore); and the case states that, while he maintains an office in the Mysore territory to supervise the cultivation work there, the labour required for the cultivation is recruited in Mangalore, materials required for the estate like manure, tools, spray materials crop-bags etc., are purchased at Mangalore, and the harvested crops are brought to Mangalore in their raw state to be dried and cleaned there in the factories of Pierce Leslie and Co., and sold there by Pierce Leslie & Co., the selling agents of the assessee. As the sale proceeds are received and retained at Mangalore and a separate staff is maintained by the assessee at Mangalore to attend to the above operations, the Commissioner was of opinion that the assessee was liable to be taxed as one carrying on 'business' and receiving the income or profits thereof in Mangalore.

As both Sec. 4 and Sec. 6 of the Indian Income Tax Act are qualified by the opening words 'save as hereinafter (otherwise) provided', the point for determination is whether the assessee can claim exemption under the Second proviso to Sec. 4 (2) and if so, to what extent. The Commissioner has expressed the opinion that proviso 2 to Sec. 4 (2) has no application here, because the profits of the business are received in Mangalore and

" the agricultural processes carried on in Mysore " are not in themselves a source of income but merely 'an element in the business which produces the income'. In support of this view, he has relied on the decisions in *3 Income Tax Cases 378* and *8 Tax Cases* at p. *204*; but it must be observed that even in *3 Income Tax Cases 378*, the proviso now to be interpreted did not come up and could not have come up for consideration and there can be little doubt that but for that proviso, the assessee in the present case will be liable to be assessed in respect of the profits to the extent determined by the authorities. After this reference had been made, the scope and effect of the proviso was considered by a Division Bench of the Calcutta High Court in *Mohanpura Tea Co. In re* (V *Income Tax Reports* edited by A.N. Ayyar, p. 118) and the judgment is a direct authority in favour of the Commissioner's view. We have carefully considered the reasoning in that judgment but, with all respect to the learned Judges, we are unable to follow that decision.

The basis of the Calcutta decision and of the Commissioner's opinion is that when a person who owns lands outside British India sells the produce of those lands in British India, no income, profits or gains can be said to arise or accrue *until the produce is sold* and that in such cases there is accordingly no room for the application of the proviso which only relates to 'income . . . arising or accruing' in an Indian State. The learned Judges emphasise the distinction between the *place* where the income accrues and the *source* from which it accrues and point out that the proviso is not concerned with the source. As a corollary, they think that if the sale also had taken place outside British India, the income, thus realised, even if subsequently received in British India, would be exempt as income from agriculture that had arisen or accrued in the State, within the meaning of that proviso. Whatever may be said as to 'profits or gains,' the view that '*income* from agriculture' can be said to arise or accrue only when and where the produce is sold and converted into money seems to us with all respect, difficult to reconcile with the reasoning in *Commissioners of Taxation* v. *Kirk* (1909 A.C. 588). Reliance was placed before us in this connection, on the observation of the Judicial Committee in *Commissioner of Income Tax, Bengal* v. *Shaw Wallace & Co.* (59 C. 1343) that the term 'income' in the Indian Income Tax Act connotes a 'periodical monetary return' coming in with some sort of regularity or expected regularity from definite sources: but their Lordships were then laying emphasis

not on the distinction between receipt in money and receipt in kind but between *recurring* receipts from a business continuously carried on and an occasional receipt of the kind then in question. On the other hand, they refer in the course of their judgment to income being likened to the 'crop of a field.' In *Maharaja of Darbhanga's case* (*12 Patna 318 at p. 336*) the Privy Council affirm that 'a receipt in kind may be taxable income'; they only add that what is received in kind should be money's worth. It was admitted before us by Mr. Patanjali Sastri that in respect of the produce a land in British India, the Indian Income-tax Act recognises the receipt of income or rent *in kind* as receipt or accrual of income; it is difficult to see why as a matter of language, the expressions 'receipt' or 'accrual' of income should not have the same significance when used in connection with the receipt of produce from lands outside British India.

In *Kirk's case*, (1900 A.C. 588) the question arose as to the assessment to be levied in New South Wales on a Company which extracted ore from mines owned by it in New South Wales and converted it into a merchantable product there but carried the product to Victoria for sale, the sale proceeds being received either in London or in Melbourne. The Judicial Committee overruled the view taken by the New South Wales Court that, "the income was not earned in New South Wales because the finished products were sold exclusively outside that Colony." Referring to the several steps which had to be gone through, from the extraction of the ore to the receipt of moneys on the sale of the merchantable product, their Lordships held that to the extent of two of the steps, *viz.*, extraction of the ore from the soil and conversion thereof into a merchantable product "the income was earned and arising and accruing in New South Wales." In the Calcutta Case, the learned Judges distinguish this decision as turning on the language of the particular statute and take it as only relating to the *source* from which the income accrued and not to the place where it accrued. With all respect, it seems to us that this way of distinguishing *Kirk's case* fails to take note of certain portions of the argument as well as of the judgment. In the New South Wales Act, there was an exemption, Sec. 27 (3), to the effect that no tax shall be payable in respect of income earned *outside* the Colony of New South Wales. On the strength of this provision, it was contended before their Lordships on behalf of the assessee that 'the income was derived from the sales, that is, from the business carried on outside the Colony. This argument they repel

with the remark that it is fallacious as "leaving out of sight the initial stages and fastening attention exclusively on the final stage in the production of the income." These relevant parts of that judgment do not seem to us to turn on any peculiarity of the New South Wales Act but to recognise that as a matter both of language and of business, receipt of produce *in kind* may well be spoken of as receipt or accrual of income at the place where the produce is received.

Mr. Patanjali Sastri had to concede that on the principle of the decision in *Kirk's case,* the assessee in this case might well be held by the Mysore State to have received the income within that State, but he contended that the remedy for any hardship arising from that possibility must be had by invoking the provisions of the Act relating to double taxation. We are not concerned here with any q3estion of double taxation or hardship caused thereby; but we refer to this aspect of the matter only to point out that if for assessment in Mysore, the assessee can in the ordinary sense of words (and not by any fiction of law) be held to have received the income in Mysore, there is no reason why for purposes of the 2nd proviso to Sec. 4 (2) the income should not in this case be held to have arisen or accrued in Mysore. The decision in *Port Said Salt Association, In re,* (59 C. 1226) does not materially help the Referring Officer in this connection. The learned Judges recognised in that case that *part* of the profits might have been 'earned' elsewhere, but they held that if the whole is 'received' in British India, no portion could escape taxation unless there be a convention to limit the claim of one State against the nationals of others. The 2nd proviso is in a sense the result of such a convention: the case cannot throw light on the interpretation of the scope of that convention.

Reliance was also placed by Mr. Sastri on the observation in *Jiwandas* v. *Commissioner of Income Tax, Punjab* (4 I.T.C. 40) to the effect that the place where the sale is effected and the price realised is the principal place, if not the place, of the accrual of profits. That statement must be understood in the light of the fact that the case then under consideration related to the liability of a British Indian assessee who only *purchased* goods in British India but sold them outside and never received or brought the proceeds into British India. Following *Sulley* v. *Attorney General* (2 Tax Cases 149) the learned Judges held that the mere purchase of goods will not amount to the carrying on of trade (except in the cases provided for in Sec. 42) and in the circumstances there was noth-

ing like receipt of income or gains or profits in British India. There was no question in that case of the receipt of produce from one's own estate: but the way the learned Judges deal with *Kirk's case* shows that if the facts before them had been similar to those in *Kirk's case* or to those in the present, they would have held that the receipt of the produce would amount to receipt of income.

Accepting our interpretation of the dicision in *Kirk's case*, Mr. Patanjali Sastri advanced an alternative argument. Assuming that the income might be held to have 'accrued' or 'arisen' to the assessee in Mysore he maintained that it might nevertheless be held to have been 'received' by the assessee in British India not merely within the meaning of cl. (2) of Sec. 4 but even within the meaning of the first part of clause (1). The purpose of this argument was in any event to exclude the operation of the second proviso which is worded as a proviso only to sub-section (2) and not to sub-section (1). The first clause deals with two kinds of receipt in British India; one, receipt in the ordinary sense of that word and the other, in an artificial or extended sense and the second clause defines the artificial or extended meaning. If the 2nd proviso qualifies only this 'artificial' sense of receipt, it would have no operation in cases where the receipt of income in British India can be held to amount to 'receipt' in its natural or ordinary sense. In support of the contention that income may 'accrue' or 'arise' in one place and yet be held to have been 'received' in another place, he relied on the decision of the Judicial Committe in the *Pondicherry Company's case*(I.L.R. 54 Mad. 691).

We may observe at the outset that in the *Pondicherry Company's case*, their Lordships were not called upon to decide whether the 'receipt' of income by the company was a receipt in the grammatical sense or in the extended or artificial sense, because the Company's contention was that there was no receipt at all, by or on their behalf in British India and that they received the income only in London. If that decision gives us any guidance at all in the present case, it may well be held that on the facts here, the receipt of the produce in Mysore itself by the assessee's men on the spot will correspond to the receipt by Mr. Rothera in the *PondicherryCompany's case* and the assessee's receipt of the income in British India can only be a receipt in the secondary stage, just like the receipt by any Nattukottai Chetty here of profits earned by a business carried on on his behalf in foreign countries. Even apart from this view of the facts, it does not seem to us necessary

or reasonable to read clauses (1) and (2) of Sec. 4 as mutually *exclusive*. The first clause comprises 'receipts' falling under the 2nd clause as well and when the facts of a case clearly bring it within the terms of the 2nd proviso, it is obviously a case which on grounds of policy the Legislature intended to exempt and it does not seem to us right to deprive the subject of this exemption by holding that the 'receipt' in British India is in the primary sense and not in the secondary sense, especially when the 2nd clause as well as the 2nd proviso speak only of 'accruing' or 'arising' outside British India and not also of being 'received' in British India. There can be no doubt that in this case the income 'accrued or arose' without British India and was 'received or brought into British India.' We would give the same answer to the argument founded on clause (3) of Sec. 42 which provides for the taxability in British India of profits or gains from the sale in British India of merchandise exported to British India from outside. Reading the clause as a whole it is evident that it refers to a person who sells goods *purchased* by him and not to one who sells the produce of his own lands. It is significant that the clause deals only with 'profits' or 'gains' and not with *income* generally.

The circumstances in which the 2nd proviso came to be inserted do not suggest any intention to make the kind of differentiation now insisted on by the Referring Officer. Prior to 1933, it was only 'profits or gains of business' outside British India that were taxed when brought into British India. The amending Bill of 1932 sought to make *all income* (not merely profits from business) accrued outside British India taxable if and when brought into British India ; the Bill therefore sought to amend only clause (2) of Sec. 4. The kind of income exempted by the 2nd proviso is undoubtedly *foreign* income and when the Legislature resolved to exempt foreign income of the particular kind dealt with in that proviso, it seems to have been thought sufficient to enact the exemption as a proviso to the 2nd clause which was then being amended for the very purpose of including 'foreign income' generally. We are accordingly of opinion that the assessee in this case is entitled to claim the benefit of the 2nd proviso to Sec. 4 (2).

It remains to determine the *extent* of the exemption which the assessee can claim. It was contended on his behalf that the *whole* of the price realised by him by the sale of the Mysore coffee in Mangalore should be excluded, but it was maintained on behalf of

the Referring Officer that the assessee is at best only entitled to a deduction of the value of the coffee beans in a raw state in Mysore. The statement of the Commissioner and an affidavit of Mr. Kirkbride, Manager of Pierce Leslie and Co., set out in detail what happens to the beans between the time when they are picked and the time they are actually sold. If the process subsequent to the picking can be regarded as in the nature of *manufacture* the assessee will on the analogy of the rule applicable to tea (see *Killing Valley Tea Co. Ltd.* v. *Secretary of State,* and rule 124 of the rules framed under Sec. 59 of the Act) be entitled to deduct only the agricultural part of the income. But the affidavit states that in the case of coffee, the process is not in the nature of a 'manufacturing' 'process but only a process ordinarily employed by the cultivator to render the produce fit to be taken to the market' [see Sec. 2 (1) (*b*) (ii)]. The learned counsel appearing for the assessee definitely asserted, that in respect of coffee grown on assessed lands in British India, this is the view adopted in practice by the income tax authorities and we have been shown nothing to the contrary. We have accordingly come to the conclusion that if the assessee can claim to be treated as on the same footing with one selling coffee grown on one's own land in British India, he is entitled to exemption in respect of the *whole* price realised by the sale of his coffee. This leads us to the consideration of the question whether the exemption under the 2nd proviso to Sec. 4 (2) is of the same scope as the exemption applicable to "agricultural income" as defined in Sec. 2 (1) of the Act.

Mr. Patanjali Sastri is certainly right in his contention that the statutory definition of 'agricultural income' does not in terms apply to cases falling within the proviso now in question. If the definition in the Act is one which is intended to include what will not otherwise be ordinarily comprehended in the meaning of the expression 'agricultural income' the assessee in the present case cannot claim the benefit of the full scope of the definition because it applies only to income derived from lands in British India. But we are inclined to agree with the learned counsel for the assessee that the statutory definition involves no artificial extension but merely embodies the significance attaching in a business sense to the word 'income' when applied to agriculture. As pointed out by ROWLATT, J., in *Back* v. *Daniels* (1924) 2 K.B. 432, if a farmer is entitled to sell his produce in the village he is equally entitled to take it to a market town and it cannot be said that he is 'commencing a new business from the time when he took his

crops from the farm on the way to the market." The same principle must apply to what he may do to make it fit for the market unless it involves such a distinct process as to justify its being regarded as in the nature of a manufacturing process. In the Court of Appeal, SCRUTTON, L. J., took the view that even if cultivation of land to grow produce for the purpose of sale is to be regarded as a trade the State by its separate system of taxing land, may reasonably be taken not to have intended to deal with it as a trade (1925, 1 K.B. at p. 543). Mr. Sastri pointed out that our conclusion would practically amount to reading the proviso in Sec. 4 into the definition of 'agricultural income' when the Legislature had not (as it might well have done) included in that definition income from assessed lands in Indian States. Having regard to the manner in which amendments have been from time to time inserted in the Act, the argument founded on the particular place where an amendment is inserted cannot have the same force here as in the case of a provision which formed part of the original scheme of the Act. As we have already explained Sec. 4 (2) might well have been thought to be the proper place for the insertion of the proviso. On the other hand we have not been shown any reason why the proviso was inserted at all and why it should have been limited to lands paying assessment to an Indian State if it was not the intention to treat the owners of such lands as on the same footing as owners of assessed lands in British India. The policy clearly was to avoid double taxation; not double taxation in the sense of payment of income tax in two places but of taxing a person who in respect of the same subject matter has already paid a reasonably heavy land tax, whether in British India or in an Indian State.

Our answer to the question referred is that the whole income derived by the assessee by the sale in Mangalore of the produce of his coffee estates in Mysore is exempt from taxation.

The assessee will be entitled to Rs. 250 for his costs and also to refund of the deposit of Rs. 100.

[IN THE RANGOON HIGH COURT.]

COMMISSIONER OF INCOME TAX, BURMA

v.

P. V. R. M. VISALAKSHI ACHI.

ROBERTS, C. J., LEACH and MACKNEY JJ.

April 2, 1937.

NON-RESIDENT—LENDING MONEY TO RESIDENT—ASSESSABILITY OF PROFITS MADE BY LOAN—LOAN, WHETHER CREATES BUSINESS CONNECTION WITH BORROWER—'BUSINESS CONNECTION,' MEANING OF—REFERENCE—PRACTICE—RIGHT TO BEGIN—ASSESSEE'S RIGHT TO BE HEARD FIRST—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 2 (4), 42 (1), 66.

Where a non-resident money-lender makes a loan to a resident in British India, each loan does not necessarily emanate from a business connection with the borrower. Further the fact that the borrower is also a money-lender is also not by itself sufficient to create a business connection within Sec. 42 (1). The assessee who resided in an Indian State and carried on a money lending business there, made four loans outside British India, three to residents in British India and one to a non-resident who had a business in British India and used the loan in that business. The profits arising from these loans were assessed under Sec. 42 (1) of the Indian Income Tax Act, on the ground that they accrued or arose to the assessee through a business connection in British India. Held, *that as the loans were isolated loans and there was nothing to show that such a series of loans were advanced or that the interest taken by the assessee in the borrower's businesses was such as to constitute a course of dealing amounting to a business connection with the borrower firms, there was no material upon which the income tax authorities could find that the profits in question accrued or arose to the assessee directly or indirectly through or from a business connection in British India and the profits were not assessable to Indian Income tax under Sec. 42 (1).*

Held *also, that in the case of a reference made at the instance of an aggrieved assessee, the assessee should normally be heard first and good reason must be shown before any departure is made from this practice.*

Per MACKNEY, J.—*The word 'business' does not merely qualify the word 'connection' by describing the sort of connection. It*

has the significance indicated in Sec. 2 (4) of the Act and denotes an adventure or concern in the nature of trade, commerce or manufacture, and the word 'connection' must be used in the sense of 'that with which one is connected'; and the expression 'any business connection' therefore means 'any adventure or concern in the nature of trade, commerce or manufacture, being a business with which he (i.e., the person residing out of British India) is connected'.

Cases referred to:

BOARD OF REVENUE, MADRAS v. RAMANATHAM CHETTY (1920) (I.L.R. 43 M. 75; 37 M.L.J. 663; A.I.R. 1920 M. 344; 1 I.T.C. 244).

COMMISSIONER OF INCOME TAX, BOMBAY v. BOMBAY TRUST CORPORATION (1928) (I.L.R. 52 Bom. 702; 30 Bom. L.R. 1172; A.I.R. 1928 Bom. 448; 113 I.C. 593; 3 I.T.C. 135).

COMMISSIONER OF INCOME TAX, BOMBAY v. BOMBAY TRUST CORPORATION (1930) (I.L.R. 54 Bom. 216; 57 I.A. 49; A.I.R. 1930 P.C. 54; 121 I.C. 532; 4 I.T.C. 312).

COMMISSIONER OF INCOME TAX, BOMBAY v. CURRIMBHOY EBRAHIM & SONS. (1935) (1935 I.T.R. 395; I.L.R. 60 Bom. 172; 159 I.C. 555; 9 I.T.C. 121; 40 C.W.N. 199).

COMMISSIONER OF INCOME TAX, BOMBAY v. REMINGTON TYPEWRITER CO. LTD. (1931) (I.L.R. 55 Bom. 243; A.I.R. 1931 P.C. 42; 130 I.C. 679; 58 I.A. 43; 5 I.T.C. 177).

KILLING VALLEY TEA CO. LTD. v. SECRETARY OF STATE (1921) (I.L.R. 48 Cal. 161; 61 I.C. 107; 1 I.T.C. 54).

JOHN & CO., *In re* (1921) (I.L.R. 43 All. 139; 18 A.L.J. 1017; 58 I.C. 836; A.I.R. 1921 All. 257; 1 I.T.C. 61).

ORIENTAL INVESTMENT CORPORATION. v. COMMISSIONER OF INCOME TAX, BOMBAY (1934) (7 I.T.C. 211).

Case stated by the Commissioner of Income Tax, Burma under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922). [Civil Ref. No. 9 of 1936].

E. W. Lambert (Asst. Govt. Advocate), for Commissioner of Income Tax, Burma.

R. Clark, for the assessee.

JUDGMENT.

ROBERTS, C.J.—This is a reference made by the Commissioner of Income Tax to the Hight Court under Sec. 66 (2) of the Income Tax Act, 1922, for the determination of a question of law. The assessee P. V. R. M. Visalakshi Achi resides in Royavaram,

Pudukotta State, outside British India and carries on the business of a money lender. First she carries on the business at Pudukotta and she lends money to persons in Burma. Some of these loans took place in Burma and accordingly the profits arising from them were assessed to income tax under S. 4. (1) of the Act. These items are enumerated in schedule A and they do not form the subject matter of any existing dispute. Secondly, other loans have been made by the assessee outside British India, altogether three to residents in British India and one to a non-resident who nevertheless has a business in British India and has used the loan in question in that business. The profits arising from these loans were assessed under Sec. 42 (1) of the Act and the items are enumerated in Sch. B. The assessee contended that Sec. 42 (1) did not apply. Sec. 42 (1) of the Act runs as follows :—

" In the case of any person residing out of British India, all profits or gains accruing or arising to such person, whether directly, or indirectly, through or from any business connexion or property in British India, shall be deemed to be income accruing or arising within British India, and shall be chargeable to income tax in the name of the agent of any such person, and such agent shall be deemed to be for all the purposes of this Act, the assessee in respect of such income tax ".

It is admitted that the respondent resides in Pudukotta. The sole question is whether the items in Sch. B must be deemed to be income accruing or arising within British India : for that purpose it is necessary to see whether they accrue or arise, directly or indirectly through or from any business connection or property in British India. The question propounded is : Whether there was any material before the Income Tax Officer upon which he cound find that the sum of Rs. 2,048-6-0 or any part of it accrued or arose to the assessee, whether directly or indirectly through or from a business connexion in British India and as such was assessable to income tax for the year 1934-35 under Sec. 42 (1) of the Act ? In addition to her own money lending business in Pudukotta the Respondent was also a partner in the P. V. Bogale money lending firm at Pyapon in Burma. There is no evidence whatever that the loans made to the persons mentioned in Sch. B were effected through or from the business connexion which the assessee had as a partner in the P. V. Bogale firm. Arising from her business connection as a parter in the P.V. Bogale firm, the respondent might lend money outside British India to persons residing in British India or for use in their businesses in British India and if

there were evidence that she did so, she would clearly be liable to assessment for income tax purposes on the profits of such loans. But it is not contended here that the loans had anything to do with the business connexion which the respondent had with the P. V. Bogale firm even in an indirect manner. The persons who borrowed from her outside British India are not shown to have done so because she was a partner in the P. V. Bogale firm.

Apart from the P. V. Bogale firm, did the respondent have any business connexion in British India from which the profits on these loans accrued or arose? The answer to this question must depend on the interpretation of the phrase "business connexion" in Sec. 42 (1) of the Act. Now it is clear that there must be a business in British India from which the business connexion arises, and the Commissioner's case is that the respondent carried on a money lending business and lent money to many persons in Burma, then a part of British India, and that from this business the business connexion arose. It is contended that when a person carries on the business of lending money each loan emanates from a business connexion with the borrower. If this contention is right then the words "business transaction" might aptly have been used in the Act. But the mere fact of a business transaction having taken place between two parties does not, to my mind, show that a business connexion has also been established between them.

In *Commissioner of Income Tax* v. *Bombay Trust Corporation* (52 Bom. 702) and *Commissioner of Income Tax* v. *Bombay Trust Corporation* (54 Bom. 216) the Hong Kong Trust Corporation lent deposits to the Bombay Company amounting to over 15 crores annually, this was about 16 times the paid up capital of the Bombay Company; there appears to have been no security and it was held on a review of the facts that a business connexion had been established. On the other hand, in *Commissioner of Income Tax* v. *Currimbhoy Ebrahim & Sons*, 60 Bom. 172, their Lordships of the Privy Council held that where the Nizam of Hyderabad (residing out of British India) in an isolated transaction lent money to the respondents in Bombay no business connexion within the meaning of Sec. 42 (1) had been established. The Nizam was not carrying on the business of a money lender in British India or in Hyderabad, and thus there was no business from which a business connexion might

arise. In the present case the respondent was carrying on the business of a money lender and the question is whether a business connexion arose from it. There is nothing in the Letter of Reference to show that these loans were other than isolated transactions between the parties. True there may have been many loan transactions between persons in Burma and the respondent, but there is no evidence of a course of dealing between the respondent and these particular borrowers (using the words of SIR GEORGE RANKIN at p. 180) "such as might fairly be described as a business previously subsisting between them". SIR GEORGE RANKIN remarked that the mere fact that Messrs. Currimbhoy Ebrahim and sons used the loan from the Nizam in connexion with their own business did not bring the Nizam any nearer to being a person who had a business connexion in British India. It was not shown that he had any interest direct or indirect with the respondent company. Similar observations might be applied to the present case.

It is contended that in annexure C to the Letter of Reference it is shown that the Assistant Commissioner of Income Tax found as a fact that "appellant makes contracts with these chetty firms to finance them" and that that shows he has a business connexion with them. In one sense anyone who lends money to another is financing that other person, but I cannot find that such a series of loans were advanced, or that the interest taken by the lender in the borrower's business was such as to constitute a course of dealing amounting to a business connexion with the firms enumerated in Sch. B. The other authorities cited to us, *Oriental Investment Corporation Ltd. Bombay* v. *Commissioner of Income Tax*, and *Income Tax Commissioner* v. *Remington Typewriter Co. Ltd.* are very different from the present case, among the distinguishing features being in the first case the amount of the loan and the fact that it remained outstanding, and in the second the mutual interest of the two typewriter companies concerned. I would answer the question propounded in the negative.

There remains one other matter. Mr. Clark for the respondents claimed the right to be heard first. When an assessee is aggrieved the Commissioner is bound to refer the question in dispute to the High Court for determination and I am of the opinion that the practice laid down in 43 Mad. 75, *Secy. to the Commissioner Salt Abkari and Separate Revenue, Madras* v. *Ramanathan Chetty*, should be followed and that the assessee should normally be heard first. I do not say that circumstances might never arise in which

it might be desirable to hear the Commissioner of Income Tax first, but the Madras practice is in conformity with that of the Calcutta and Allahabad High Courts; [See *Killing Valley Tea Co.* v. *Secy. of State, Re John and Co.*] and good reason should be shown before any departure is made from it. The Commissioner of Income Tax must pay the costs of this reference, 20 Gold Mohurs, and in addition the Rs. 100 deposited under Sec. 66 (2) should be refunded to the assessee.

LEACH, J.—I agree that the question propounded must be answered in the negative. There is no evidence that the profits which the income-tax authorities seek to tax have arisen from any business connexion in British India. On the facts stated in the reference the loans can only be treated as isolated transactions entered into outside British India. I also agree with the remarks of the learned Chief Justice with regard to the right to begin.

MACKNEY, J.—I agree. The reference has been worded in rather a curious manner; for evidently the point upon which our opinion is desired is whether the Income Tax Officer in applying his mind to the facts of the case has employed an interpretation correct in law, to Sub-S. (1) of Sec. 42, Income Tax Act. With regard to Sub-S. (1) of Sec. 42, Income Tax Act, it appears to me that the expression "business connexion" is a composite expression. Its meaning can best be ascertained on a consideration of its context. "All profits or gains accruing or arising, whether directly or indirectly, through or from any business connexion . . . in British India."

Profits must arise through or from business dealings: they can be ascertained only by looking at the profit arising through or from such dealings. "Profit" in the general sense may arise through or from a "business connexion" (taking that phrase in the special sense of "existence of a regular clientele") where the existence of such regular clientele brings fresh business, but clearly the actual profits or gains which it might be possible to tax arise through or from the fresh business itself. Inasmuch, therefore, as in this section the reference is to actual profits or gains, the expression "business connexion", must denote something which produces profit or gains and not a mere state or condition which is favourable to the making of profit. Again if the word "business" only qualifies the word "connexion" by describing the sort of connexion (taking the word in the sense of "being connected") we meet with the same difficulty in the phrase "profits arising through or from" such connexion, *i.e.*, profits

do not arise through or from the fact of connexion. The word "business" must therefore have the significance indicated in Sec. 2 (4) of the Act and denote an adventure or concern in the nature of trade, commerce or manufacture: and the word "connexion" must be used in the sense of "that with which one is connected," so that in order to make clear the meaning of the expression "any business connexion" we may expand it thus: "any adventure or concern in the nature of trade, commerce or manufacture being a business with which he (that is the person residing out of British India) is connected."

That there must be some "adventure or concern" is clear from the fact that under Sub-Sec. 1 the person residing out of British India is chargeable to income tax in the name of the agent of any such person. Sec. 43 of the Act explains the use of the word "agent"; "Any person employed by or on behalf of a person residing out of British India, or having any business connexion with such person, or through whom such person is in the receipt of any income, profits or gains upon whom the Income tax officer has caused a notice to be served of his intention of treating him as the agent of the non-resident person shall, for all the purposes of this Act, be deemed to be such agent:

Provided that no person shall be deemed to be the agent of a non-resident person, unless he has had an opportunity of being heard by the Income Tax Officer as to his liability."

"Having any business connexion with such person" must be interpreted consistently with what has been said in the foregoing and must mean "conducting a business being a business with which such person is connected." And "through whom such person is in the receipt of any income" does not mean "from" whom that is, a person paying interest to a person out of British India on a loan taken by him from that person is not one through whom income is received but one from whom income is received and he cannot be deemed to be an agent of that person. Now P. V. R. M. Visalakshi Achi referred to as the assessee has no agent for any seat of business in British India. She is a partner in a money-lending firm in Burma known as P. V. Bogale, but the loans in question have nothing to do with that firm. She also carries on a money-lending business in Royavaram which is in British India. The loans in question (shown in Sch. B.) were made at Royavaram in the course of that business. Many of the loans shown in Sch. A were also made in Burma in the course of the same business to persons in Burma.

There is no business in Burma of which these loans were the acts. The series of loans does not constitute a business (as defined) in Burma: it is no more than a section of the business dealings of the business in Royavaram. Nor could a series of her own business dealings be reasonably described as a "business with which she is connected."

Is there any evidence of any business connexion between the assessee and the individuals to whom the loans were made? There is none. The Assistant Commissioner of Income Tax, it is true, in his appellate order (see annexure C to the Commissioner's reference) says "appellant makes contract with the proprietors of these chettiyar concerns and finances them." If this were a fact of course the case would be entirely different; but the Commissioner makes no reference to this statement and it is apparent that the Assistant Commissioner is using the word "finance merely in the sense of lending money." The mere lending of money purely as a loan to a person in business does not establish a business connexion with the person; the business of the borrower does not thereby necessarily become connected with the lender. He is indifferent to it—unless indeed his money is jeopardised, in which case he may take steps to become connected with the business. The view here set out appears to me to be consistent with all the decisions to which our attention was directed. As regards the passage in *Currimbhoy Ebrahim & Sons' Case* on which the Commissioner of Income Tax has relied so strongly ("there is no proof that the Nizam is carring on business of money-lending either in Hyderabad or British India"), I do not think it bears the interpretation which it is sought to fasten upon it. Looking at the context it is clear that the sentence is but another way of saying that the loan made by the Nizam was an isolated transaction. It is a comment on the absence of one of the conditions which one would ordinarily expect to find in a case where there was a business connexion. The sentence in my opinion does not imply either that it was a necessary condition or that it was the sole determining condition.

Answer accordingly.

[IN THE RANGOON HIGH COURT].

COMMISSIONER OF INCOME TAX, BURMA

v.

A. S. A. CONCERN, BASSEIN.

ROBERTS, C.J., LEACH and MACKNEY, JJ.

April 2, 1937.

MONEY-LENDING BUSINESS—FOREIGN PROFITS—LOSS ON EXCHANGE, WHETHER ADMISSIBLE DEDUCTION—CAPITAL LOSS—LOSS OF PROFITS—BUSINESS EXPENDITURE—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 4 (2), and 10 (2) (ix).

Where a person residing in British India carries on a money lending business at a place outside British India where a different currency prevails, the loss incurred by him owing to variation in the rate of exchange must be deducted from the profits of such business which he receives in British India in computing his income for the purposes of assessment to Indian income tax. Such loss is not loss of capital but an allowance admissible under Sec. 10 (2) (ix).

The assessee who resided in Burma, remitted in 1925 Rs. 1,30,738 to her agent at Saigon for carrying on a money lending business there. In 1931 she received back a sum of Rs. 1,32,375. It was found that in fact she had made a profit of 21,988 dollars (Rs. 23,252) and that it was because of a variation in the rate of exchange that she had received only Rs. 1,32,375. Held *that the whole amount of Rs. 23,252 was not taxable under Sec. 4 (2), that this sum should be reduced by the loss on exchange and income tax could be levied only on Rs. 1,637 (the difference between Rs. 1,32,375 and Rs. 1,30,738).*

Cases referred to:

COMMISSIONER OF INCOME TAX, BENGAL *v.* SHAW WALLACE & Co. [1932] (I.L.R. 59 Cal. 1343; 59 I.A. 206; 136 I.C. 742; A.I.R. 1932 P.C. 138; 36 C.W.N. 653; 34 Bom. L.R. 1033; 63 M.L.J. 124; 1932 Comp. Cas. 276; 6 I.T.C. 178) P.C.

PUNJAB NATIONAL BANK LTD. *v.* EMPEROR [1926] (I.L.R. 7 Lah. 227; 27 P.L.R. 416; A.I.R. 1926 Lah. 373; 96 I.C. 380; 2 I.T.C. 184).

RAMASWAMI CHETTIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS [1930] (I.L.R. 53 Mad. 904; A.I.R. 1930 Mad. 808; 59 M.L.J. 403; 32 L.W. 287; 127 I.C. 611; 4 I.T.C. 438).

REID'S BREWERY CO. LTD. *v.* MALE [1891] (2 Q.B.D. 1; 60 L.J.Q.B. 340; 64 L.T. 294; 3 Tax Cas. 279).

Case stated by the Commissioner of Income Tax, Burma, under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922)

Civil Reference No. 10 of 1936.

E. W. Lambert for the Commissioner.
R. Clark for the Assessee.

JUDGMENT.

LEACH, J.—This is a reference by the Commissioner of Income tax, Burma, under the provisions of Sec. 66 (2) of the Income tax Act, 1922. The assessee carries on a money-lending business at Bassein under the *vilasam* of A.S A. In 1925, the assessee remitted to her agent in Saigon three sums of money aggregating to Rs. 1,30,737-15-0 to enable the agent to lend out these moneys at interest in Saigon. In other words, she wanted to do through her agent in Saigon, a similar business to the business which she was doing at Bassein. The moneys, of course were received by the agent in Saigon in dollars. The agent obeyed these instructions and the loans made by him on behalf of the assessee earned in interest 25,813 dollars before the beginning of the financial year 1929-30 ; and in the three financial years 1929-30, 1930-31 and 1931-32 they earned 21,988 dollars. In 1931, the assessee decided to bring back most of her money from Saigon and in accordance with her instructions her agent remitted 25,000 dollars which, when received in Bassein in rupees, amounted to Rs. 1,32,375. Only 5,500 dollars remained in the hands of the Saigon agent.

When the Income Tax Officer came to assess the assessee for the year 1932-33, he discovered that the sum of 21,988 dollars had been earned on interest on the Saigon loans during the three years I have mentioned, and he decided that the assessee should pay income tax on this amount. The rupee equivalent of the 21,988 dollars is Rs. 23,252. His decision was based on the presumption that profits are remitted before the capital and that the sum of Rs. 1,32,375 received by the assessee in 1932 from her Saigon agent included his amount. The assessee contended, however, that the total profits received from Saigon amounted only to Rs. 1,637 (Rs. 1,32,375 less Rs. 1,30,738). This was the result of the rate of exchange being against her when the Saigon agent remitted the money to Rangoon. The assessee appealed to the Assistant Commissioner against the decision of the Income Tax Officer but her appeal was disallowed. She accordingly required the Commission-

er of Income Tax to refer the matter to this Court, which he has done, framing the question as follows:

"Whether on the facts of this case the whole sum of Rs. 23,252. is taxable under Sec. 4 (2) or whether it should be reduced by the loss in exchange?"

Under Sec. 4 (2) of the Act, profits and gains of a business accruing or arising without British India to a person resident in British India shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be the profits and gains of the year in which they are so received or brought, notwithstanding the fact that they did not accrue or arise in that year, provided that they are received or brought in within three years of the end of the year in which they accrued or arose. Therefore, the assessee is clearly liable to be taxed on the profits made in Saigon and brought into this country. But it is equally clear that the profits brought did not amount to Rs. 23,252 as the Income tax authorities would have, but only to Rs. 1,647. The Judicial Committee of the Privy Council pointed out in *Commissioner of Income Tax, Bengal* v. *Shaw Wallace & Co.* that the object of the Act is to tax 'income' which here connotes a periodical monetary return 'coming in' with some sort of regularity or expected regularity from definite sources. The taxable income of the assessee is interest received from loans made by her, but until she actually receives the interest it is not taxable. When she sent the money to Saigon to be utilised there in the course of her business she had of necessity to change the rupees into dollars and when she wished to bring back the money she had to change the dollars into rupees. The rate of exchange was an important factor. An adverse exchange meant less profit to her, a favourable exchange meant more profit. It is impossible to make a true estimate of the assessee's profits on the Saigon business without taking into consideration what she lost or gained on the rate of exchange. Moreover Sec. 10 (2) (ix) of the Act provides that in computing profits allowance may be made for any expenditure (not in the nature of capital expenditure) incurred solely for the purpose of earning such profit. The conversion of rupees into dollars and dollars back again into rupees was necessary to enable the assessee to earn profits in Saigon and to be put in possession of these profits. Then it must be remembered that a money-lender's stock in trade consists of the money which he has for the purpose of carrying on his business: *Punjab National Bank Ltd.* v. *Emperor* and *Ramaswamy Chettiyar* v. *Commissioner of Income*

Tax, Madras. When a money lender makes a bad debt in the course of his business that loss is allowed as a deduction for income tax purposes: *Reid's Brewery Co., Ltd.* v. *Male.* In these circumstances the loss on exchange cannot be classified as a loss of capital. The Income tax Officer started off with a presumption which he was not entitled to in face of the facts and as his presumption goes so must his assessment. The answer to the question referred is that the whole of the sum of Rs. 23,252 is not taxable under Sec. 4 (2) and must be reduced by the loss on exchange. The assessee is entitled to the costs of this reference which we fix at 15 gold mohurs. He is also entitled to the return of the Rs. 100, the deposit made in connection with the reference.

ROBERTS, C.J.—I agree.

MACKNEY, J.—I agree.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

MERCHANT FLOUR MILLS CO., LTD.
v.
COMMISSIONER OF INCOME TAX, PUNJAB.

DALIP SINGH and SKEMP, JJ.

July 13, 1937.

REFERENCE—LIMITATION FOR MAKING APPLICATION TO COMMISSIONER—COMMISSIONER'S POWER TO EXTEND TIME—APPLICATION FOR COPY OF ASSISTANT COMMISSIONER'S ORDER—WHETHER REQUIRES STAMP DUTY—ASSISTANT COMMISSIONER, WHETHER 'COURT'—INDIAN INCOME TAX ACT (XI of 1922), SEC. 66 (2).

The Commissioner of Income Tax has no power to extend the period of limitation allowed by Sec. 66 (2) of the Indian Income Tax Act for making an application to him to state a case to the High Court.

An Assistant Commissioner of Income Tax is a revenue Court for the purpose of the Court Fees Act and an application to him for a copy of an order made by him must therefore be stamped with the stamp duty which is leviable under the Court Fees Act on an

application presented to a Revenue Court for a copy of an order passed by such Court.

Cases referred to:

BASANTLAL RAMJIDAS *v.* COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA [1932] (I.L.R. 10 Pat. 40; 136 I.C. 302; A.I.R. 1932 Pat. 103; 5 I.T.C. 383).

COMMISSIONER OF INCOME TAX, MADRAS *v.* MOTHAY GANGA RAJU [1927] (I.L.R. 50 Mad. 335; 52 M.L.J. 273; 2 I.T.C. 291; 100 I.C. 291; A.I.R. 1927 Mad. 545).

EMPEROR *v.* RUP SINGH [1905] (44 P.R. 1905; 3 Cr. L. J. 128).

KALIDAS *In re* [1906] (8 Bom L.R. 477).

NATARAJA IYER, *In re* [1913] (I.L.R. 36 Mad. 72).

PUNAMCHAND MANEKLAL, *In re* [1914] (I.L.R. 38 Bom. 642).

Application under Section 66 (3) and 66 (3A) of the Indian Income Tax Act, 1922 [Civil Miscellaneous No. 231 of 1937].

Kirparam Bajaj for the Applicant.

J. N. Aggarwal for the Commissioner of Income Tax.

ORDER.

SKEMP, J.—This is a petition under Sec. 66 (3-A) of the Income Tax Act made in consequence of a refusal by the Commissioner of Income Tax to make a reference to the High Court under Sec. 66 (2). The Commissioner rejected the application to him (a) as barred by time and (b) on the merits.

A preliminary objection that the present petition was barred by time was withdrawn and I will proceed to consider whether the Commissioner was right in holding that the application to him was barred by time. His reasoning was that the appellate order of the Assistant Commissioner of Income Tax was communicated to the assessee on the 12th August 1936, and the application made to the Commissioner on the 19th October. The assessee had applied for a copy of the Assistant Commissioner's order by *unstamped* letter on the 12th August, received on the 13th. The Income Tax Officer replied on the 19th, (delivered on the 22nd) pointing out that Court fee stamp was necessary. An application duly stamped with a two annas stamp was made on the 24th August and the copy delivered on the 27th.

The period of limitation for an application under Sec. 66 (2) is sixty days which expired on the 10th August so that the application was late by nine days, only four days being allowable.

The learned counsel for the assessee explained that the certified copy of the Assistant Commissioner's order which was sent to him by his client was marked, 'date of application 13th August 1936.' Relying on this as correct he thought he had from the 13th to the 27th August to deduct as the period requisite for taking a copy and thus the application was within time. He further stated that the Commissioner had disposed of the application without calling on him personally.

Under the law as it stands, the Commissioner of Income Tax has no power to extend limitation in reference to an application under Sec. 66. Section 30 (2) of the Act does confer powers on the Assistant Commissioner to admit an appeal after the expiration of the usual period if he is satisfied that the appellant had sufficient cause, *i.e.*, for such appeals there is a provision analogous to that of Sec. 5 of the Limitation Act; but there is no such provision for applications to the Commissioner. This has already been held by a Full Bench of the Madras High Court in *Commissioner of Income Tax, Madras* v. *Mothay Ganga Raju* (50 Mad. 335). The learned Chief Justice SIR COUTTS TROTTER said: "The third question is whether there was any power to extend the period in this case or whether the Commissioner had no discretion in the matter. The answer is that the statute fixes a time and it would be an obviously undesirable burden on the Income Tax Commissioner to put upon him the consideration of questions as to whether he should exercise discretion in the direction of leniency in one case and not in another. The statute is express and there is no provision in it for any official or even for the Court to extend the time." I do not myself understand why a discretion should be denied to the Commissioner which is granted to the Assistant Commissioner, but there it is. Nor does Section 5 of the Limitation Act apply. It applies to "any appeal or application for a review of judgment or for leave to appeal or any other application to which this section may be made applicable by or under any enactment for the time being in force." Therefore, *prima facie* the Income Tax Commissioner was right in holding the application to be time barred though the petitioner's counsel was misled by the date of application given by the Income tax Department on the certified copy.

It was then argued that the application for a copy did not require to be stamped and thus the application was within time. Stamp duty of two annas on the application purports to be levied under Article 1 (a) of the second schedule of the Court Fees Act

as amended for the Punjab. This applies in terms to an application "presented to any civil, criminal or revenue Court or to any Board or executive officer for the purpose of obtaining a copy or translation of any judgment, decree or order passed by such Court, Board, or officer." The question is whether the Assistant Commissioner of Income-tax is a revenue Court or an executive officer. Obviously he does not fall within the other part of the definition.

In *Basant Lal Ramjidas* v. *Commissioner of Income Tax, Bihar & Orissa* a reference under the Income-tax Act, where the facts are very similar, the Patna High Court held that an application had to be stamped and that an unstamped application was an invalid application. The learned Chief Justice said: "The most material words of the paragraph are the words 'judgments, decrees or orders passed by such Court, Board or officer' and they are intended to cover every case of every kind in which a judgment, decree or order has been passed by any Court, Board or officer capable of passing such judgment, decree or order and having regard to what I think is the proper meaning of the words it certainly covers an application to an Assistant Commissioner of Income-tax who has power to make the order and a copy of whose order is necessary for the purpose of preferring an appeal to the Commissioner under the Income-tax Act." With due respect to the learned Chief Justice I would look at the matter in a rather different way and say that the question is whether the Assistant Commissioner is a Revenue Court or an executive officer.

It has twice been held that a Collector or a Collector of Income-tax was a revenue Court under the Income-tax Act of 1886 and once that he was a Court. In *Emperor* v. *Rup Singh* SIR WILLIAM CLARK said: "The Collector in hearing the objection was acting under Chapter IV of the Income Tax Act II of 1886; the objection was required to be verified in the manner required by law for the verification of plaints [Sec. 25 (1)]; the Collector had power to compel witnesses to give evidence (Sec. 28); the proceedings are to be deemed to be judicial proceedings within the meaning of Secs. 193 and 228 of the Indian Penal Code."

The present Act, the Income Tax Act of 1922, by Sec. 30 (3) requires verification in a prescribed manner and Sec. 37 confers on officers "the same powers as are vested in a Court under the Code of Civil Procedure, 1908, for enforcing the attendance of

witnesses, examining them on oath, compelling the production of documents and issuing commissions for the examination of witnesses. This ruling therefore appears to cover the point.

The reasoning in *Punamchand Maneklal, In re* (38 Bom. 642) is similar; see HEATON, J.'s judgment (p. 645). The learned Chief Justice in his judgment (p. 651) considered the question of "Revenue Courts" as set up under the Punjab Tenancy Act and other provincial enactments and held that an Income-tax Collector was a Revenue Court although it is quite obvious and must have been present to the minds of the Judges who decided *Emperor* v. *Rup-Singh* (44 P.R. 1905) that a Collector is not the same as a Revenue Court under the Punjab Tenancy Act.

The Bombay ruling dissented from an earlier ruling of the same Court, *In re Kalidas* (8 Bom. L.R. 447), which however gave no reasons. In *In re Nataraja Iyer* (I.L.R. 36 Madras 72) at pp. 84-86 it was held that a Divisional Officer under the Income-tax Act was a Court. SUNDARA AYYAR, J., held that the test for deciding whether the Income-tax Officer was a Court or not was whether he was a tribunal empowered to deal with a particular matter and authorised to receive evidence bearing on that matter in order to enable him to arrive at a determination. He proceeded: "In my opinion there was a *lis* in this case. It is not necessary that there should be two parties arrayed as opponents in the matter to be decided by the officer. The petitioner had a right that he should not be made to pay a heavier tax than was properly assessable on his income. The Officer had to decide as between the petitioner and Government what the petitioner's income was."

I think the reasoning of these last three rulings is convincing. It is true that they all dealt with applications for criminal prosecution, but it is hard to say that a particular officer is a Revenue Court for purposes of Section 476 of the Criminal Procedure Code and yet not a Revenue Court for purposes of the Court Fees Act.

I would, therefore, hold that the Assistant Commissioner of Income Tax is a Revenue Court for purposes of the Court Fees Act. The application therefore required a stamp and the petition to the Commissioner is rightly held by him to be barred by time. We have no power to extend time and therefore the present petition must be dismissed. But as the petitioner who has paid Rs. 100 to the Department has not even had a hearing on this application and as the Department is partly to blame for the appli-

cation being put in late, I would direct that the parties bear their own costs of this application.

DALIP SINGH, J.—I agree.

Application dismissed.

[IN THE LAHORE HIGH COURT.]

GANGA RAM BALMOKAND *v.* COMMISSIONER OF INCOME TAX, PUNJAB.

COLDSTREAM and DIN MOHAMMAD, JJ.

April 30, 1937.

ACCOUNTING—ACCOUNTS UNRELIABLE OR INCOMPLETE—POWER TO MAKE ASSESSMENT UNDER PROVISO TO SEC. 13—SCOPE OF SECS. 23 (3) and 13—'METHOD EMPLOYED', MEANING OF—ASSESSMENT UNDER SEC. 13, PROVISO—FINALITY—INCOME TAX OFFICER'S ESTIMATE—INTERFERENCE, WHEN PROPER—INCOME TAX PROCEEDINGS WHETHER, JUDICIAL PROCEEDINGS—NATURE OF EVIDENCE ON WHICH AUTHORITIES MAY ACT—ACCOUNT UNRELIABLE—APPLICATION OF FLAT RATE—PROPRIETY—INTERFERENCE—BURDEN OF PROOF OF FAIRNESS OF ESTIMATE—INCOME TAX ACT (XI OF 1922), SECS. 13, 23 (3).

The only section under which the method of computing income for the purposes of Secs. 10, 11 and 12 is provided for is Sec. 13 and the only section under which an assessment can be made, or in other words, the amount of rate at which an assessee is to be assessed is Sec. 23 and no other. To divorce, therefore, Sec. 13 from Sec. 23 or to consider that they occupy detached positions, one having no connection with the other, is to misappreciate the whole tenor of the income tax law.

There is no warrant for restricting the interpretation to be put on the words 'method employed' as used in the second alternative dealt with in the proviso to Sec. 13. In ordinary parlance these words convey the idea of 'the manner in which accounts are kept' and they are used in the same sense in the said proviso. If the accounts tendered by the assessee are found to be incorrect or incomplete, if they are 'cooked' or 'fictitious', it will not be wrong to say that the method of accounting is such that it is not possible to deduce the total income of the assessee therefrom.

Consequently, while making an assessment under Sec. 23 (3) it is open to the Income Tax Officer to invoke the proviso to Sec. 13, if after examining the accounts produced by the assessee under Sec. 22 (4) or after recording the evidence led by the assessee under Sec. 23 (2) he still remains unconvinced as to the reliability of the assessee's accounts, and considers that they do not serve as a safe guide in calculating the assessee's taxable income.

Even assuming that the word ' method ' is used in any restricted sense in the second alternative in the proviso to Sec. 13, where an Income Tax Officer rejects the assessee's accounts on the ground that he keeps no stock registers or vouchers or that he employs an inventory system only, which is not conclusive in the matter of determining the true state of affairs, it cannot be said that he does not attack the method of accounting and he can, therefore, make use of the proviso to Sec. 13 in determining the taxable income.

The law does not impose any burden on the income tax authorities to prove by 'positive evidence' that the accounts are unreliable or that the figure at which they assess is the correct figure. On the other hand, the question of the unreliability of accounts is a question of fact and primarily falls for the determination of the Income tax authorities alone. If, therefore, it is once decided by them that the accounts are fictitious or unreliable, their finding cannot be disturbed unless it is altogether capricious and injudicial. In matters like these a very wide discretion vests in the income tax authorities in view of the exigencies of the case, and the control exercisable on them is very meagre. What alone has to be seen in such cases is whether the discretion has been judicially exercised and if it is once found to be so exercised, no court can interfere with the order.

The is no warrant for the view that in spite of the unreliability of the books of account produced by the assessee, the Income Tax Officer is bound to base the assessment on those accounts in the absence of any positive evidence to the contrary.

The proceedings before the Income Tax Officer are not judicial proceedings in the sense in which this term is ordinarily used, and all that is required of him is to proceed without bias and give sufficient opportunity to the assessee to place his case before him, or in other words, to conduct himself in accordance with the rules of justice, equity and good conscience.

In a reference under Sec. 66 of the Income Tax Act the power of the High Court is not confined to the decision of the question of law as formulated by the Commissioner or the Court issuing the mandamus. It has full power to decide the question of law in the

from it actually arises from the statement of the case made by the Commissioner.

Where the income tax authorities were not satisfied with the correctness or completeness of the assessees' accounts and, taking into consideration the state of affairs in general, and the fact that the assessees had a large business and the profit shown by them was abnormally low in comparison with that of other persons carrying on the same business in the locality, calculated the taxable income by applying a flat rate of 7 per cent, Held: *that the authorities were justified in applying a flat rate, and the burden was on the assessees to displace the estimate.*

Cases referred to:—

ANDERSON *v.* COMMISSIONERS OF INLAND REVENUE [1933] (18 Tax Cas. 320).

BAIJNATH *v.* COMMISSIONER OF INCOME TAX, LAHORE [1926] (94 I.C. 156; 2 I.T.C. 176).

BHAGWAT HALWAI, *In re* [1928] (3 I.T.C. 48).

BHIKHAJI VYANKATESH *v.* COMMISSIONER OF INCOME TAX, C. P. [1927] (103 I.C. 38; A.I.R. 1927 Nag. 283).

COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA *v.* SIR KAMESWAR SINGH [1933] (I. L. R. 12 Pat. 318; 1933 I. T. R. 94; A.I.R. 1933 P.C. 108; 6 I.T.C. 401) [P.C.]

COMMISSIONER OF INCOME TAX, BOMBAY *v.* BOMBAY TRUST CORPORATION [1936] (A. I. R. 1936 P. C. 269; 1936 I. T. R. 323; 164 I. C. 18) [P.C.]

COMMISSIONER OF INCOME TAX, BURMA *v.* CHAN LO CHWAN [1929] (I. L. R. 7 Rang. 281; A. I. R. 1929 Rang. 102; 3 I. T. C. 397).

COMMISSIONER OF INCOME TAX, BURMA *v.* E. M. CHETTIAR FIRM [1930] (I. L. R. 7 Rang. 635; A. I. R. 1930 Rang. 4; 122 I.C. 898; 4 I.T.C. 111).

DUNICHAND DANIRAM *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1926] (I.L.R. 7 Lah. 201; 2 I.T.C. 188; 94 I.C. 614).

GOPINATH NAIK *v.* COMMISSIONER OF INCOME TAX, U.P. [1935] (I.L.R. 58 All. 200; 1936 I.T.R. 1; 9 I.T.C. 136; 162 I.C. 103; A.I.R. 1936 All. 286).

HARMUKHRAI DULICHAND, *In re* [1928] (I.L.R. 56 Cal. 39; 3 I.T.C. 198; 32 C.W.N. 710; A.I.R. 1928 Cal. 587).

HUNT *v.* JOLY [1929] (14 Tax Cas. 165).

IBRAHIMBHAI M. BADRUDDIN *v.* COMMISSIONER OF INCOME TAX, C.P. [1931] (5 I.T.C. 302).

JAMBUDAS v. INCOME TAX COMMISSIONER [1927] (104 I.C. 336; A.I.R. 1927 Nag. 336).

JEWAN SHAH MAYA SHAH v. COMMISSIONER OF INCOME TAX, PUNJAB [1934] (1934 I.T.R. 343 ; 7 I.T.C. 403).

LOCAL GOVERNMENT BOARD v. ALRIDGE [1915] (1915 A.C. 120; 72 L.J.K.B. 84 ; 30 T.L.R. 672).

MUHAMMAD HAYAT v. COMMISSIONER OF INCOME TAX, PUNJAB [1931] (I.L.R. 12 Lah. 129; 5 I.T.C. 159 ; A.I.R. 1931 Lah. 87).

NARAYAN ATMARAM PATKAR v. COMMISSIONER OF INCOME TAX, BOMBAY [1934] (1934 I.T.R. 486; 7 I.T.C. 207; A.I.R. 1934 Bom. 297 ; 36 Bom. L.R. 818).

NATHURAM v. COMMISSIONER OF INCOME TAX, PUNJAB [1936] [9 I.T.C. 178].

PIONEER SPORTS LTD., SIALKOT v. COMMISSIONER OF INCOME TAX, PUNJAB [1934] (7 I.T.C. 386; 1934 I.T.R. 305; A.I.R. 1934 Lah. 876).

QUEEN v. SPECIAL COMMISSIONERS OF INCOME TAX, IN RE FLETCHER [1894] (3 Tax Cas. 289; 71 L.T. 541).

R. v. INCOME TAX SPECIAL COMMISSIONERS ; ELMHIRST, EX-PARTE [1936] (52 T.L.R. 143; 1936, 1 K.B. 487; 105 L.J.K.B. 759).

ROCHIRAM KHATTAR, *In re* [1933] (6 I.T.C. 127).

SHIVA PRASAD GUPTA, IN RE [1929] (3 I.T.C 406 ; 124 I.C. 467 ; A.I.R. 1929 All. 819).

STOCKS v. SULLEY [1899] (4 Tax. Cas. 98 ; 36 Sc. L.R. 202).

TARACHAND POHUMAL v. COMMISSIONER OF INCOME TAX, PUNJAB [1936] (1936 I.T.R. 313 ; 9 I.T.C. 256).

TUDOR AND ONIONS v. DUCKER [1924] (8 Tax. Cas. 591).

WALL v. COOPER [1922] (14 Tax. Cas. 552).

Case stated by the Commissioner of Income Tax, Punjab, N. W. F. and Delhi Provinces, under Sec. 66 (3) of the Indian Income Tax Act (XI of 1922) in the matter of the assessment of Messrs. Ganga Ram Balmokand for the assessment year 1933-34. [Civil Ref. No. 4 of 1937]. The necessary facts are stated in the judgment. For the order of the High Court requiring the Commis-missioner to state the case to the High Court see 1937 I.T.R. 65.

Kirparam Bajaj for the assessees.

J. N. Aggarwal for the .Commissioner of Income Tax.

JUDGMENT.

DIN MOHAMMAD, J.—This is a reference under sub-sec. (3) of Section 66 of the Income-tax Act and has arisen in the following circumstances :—

The assessee is a firm of soap manufacturers carrying on business in partnership under the style of Messrs. Ganga Ram Balmokand, hereinafter called 'the firm', and the assessment in dispute relates to the year 1933-34. In response to a notice issued under Sec. 22 of the Income-tax Act, the firm furnished a return of its total income during the 'previous year' to which were appended trading and profit and loss accounts certified by a firm of professional accountants. On receipt of this return, the Income tax Officer served a notice on the firm under sub-section (4) of Sec. 22 and in compliance therewith the firm produced certain books of account, mainly consisting of a *rokar* (Day Book) and purchase and sale registers. The Income-tax Officer then served a notice on the firm under sub-section 2 of Sec. 23 of the Income-tax Act and in pursuance thereof the firm produced the head of the family and a *munim* in support of its accounts. The Income-tax Officer was however, not satisfied with the correctness or the completeness of the firm's accounts and he consequently raised the value of sales from Rs. 3,14,465 to Rs. 3,50,300. He further calculated the taxable income of the firm by discarding the rate of profit shown by the firm and applying a flat rate of Rs. 7 per cent to the amount determined by him. From this order the firm preferred an appeal to the Assistant Commissioner and, in the first instance, he remanded the case to the Income-tax Officer for further enquiry. On receipt, however, of the report of the Income-tax Officer on remand, he declined to interfere with the order of assessment. It appears that both these officers were, among other things, mainly impressed by

(1) the absence of any stock register and vouchers;

(2) the inability of the firm to prove the total consumption of raw materials as shown in its accounts;

(3) the huge amount of sales, and the abnormally low rate of profit shown by the firm as compared with the other soap manufacturers in the locality.

The firm demurred to the action taken by these officers and applied to the Commissioner under Sec. 66 to refer the questions of law formulated by it to this Court. To this the Commissioner did not agree and the firm then applied to the court under sub-section (3) of Sec. 66. The position taken by the firm was that, inasmuch as the Commissioner had expressly stated that Sec. 13 of the Income-tax Act had not been applied in this case, the Income-tax Officer was bound under the terms of sub-section (3) of Sec. 23 of the Income-tax Act to assess the firm on the material

placed before him and not arbitrarily to make his own estimate of the total income that had accrued to the firm and of the profits that had arisen therefrom. Impressed by the argument advanced by the firm, a Division Bench of this Court admitted the case to a hearing and ultimately issued a mandamus to the Commissioner to state the case. The question propounded by this court was in the following terms:

" Whether there was no material for the finding of the Income-tax authorities arrived at under Sec. 23 (3) of the Act that the sales should be raised from the figure shown in the books to Rs. 3,50,000 and that the correct flat rate for the calculation of profit was Rs. 7 per cent on the sales ".

In the statement submitted by the Commissioner he has reiterated his assertion that the proviso to Sec. 13 cannot be applied to such cases, that the accounts of the firms were not rejected under that proviso, that it is not necessary to reject the accounts under the proviso before what is called a 'random assessment' can be made and that Sec. 23 (3) independently of the proviso to Sec. 13 empowers an Income-tax Officer to make an estimate of the taxable income to the best of his judgment. He has, however, indicated at the same time, if this court be not prepared to agree with him, the assessment in dispute can still be maintained under Sec. 23 (3) read with the proviso to Sec. 13.

I have given the case my most earnest consideration, in view of the importance on the question involved and the tenacity with which the Commissioner has adhered to his position, and have come to the conclusion that the Commissioner's view as regards the inapplicability of the proviso to Sec. 13 in such cases is not maintainable, and that he is equally wrong in suggesting that under Sec. 23 (3), unaffected by the proviso to Sec. 13, an Income-tax Officer can make any estimate that he likes, even though it is not supported by any relevant or admissible material on the record.

It will be necessary to examine the whole scheme of the Act in this connection. Chapter I deals with " Charge of Income-tax " and consists of two sections, *viz.*, Secs. 3 and 4, the former dealing with " Charge of Income-tax " and the latter with " Application of the Act." Chapter II is headed " Income-tax Authorities", and comprises one section only, *viz.*, Sec. 5, describing the various authorities that can be appointed under the Act. Then comes Chapter III dealing with " Taxable Income " and comprising Secs. 6 to 7. Sec. 6 enumerates the various heads of

income chargeable to income-tax, and Secs. 7 to 12 deal in detail with the six heads of income mentioned in Sec. 6. Of these Sec. 10 relates to 'business', Sec. 11 to 'professional earnings' and Sec. 12 to 'other sources'. Sec. 13 is restricted in its applications to Secs. 10, 11 and 12 only, and deals with the method of computation of income under these sections. The substantive part of this section lays down that taxable income, profits and gains shall be computed, for the purposes of Secs. 10, 11 and 12, in accordance with the method of accounting regularly employed by the assessee. The proviso to this section provides for those cases in which either no method of accounting is found to have been regularly employed by the assessee or the method employed is such that *in the opinion of the Income-tax Officer, the income-profits and gains cannot properly be deduced therefrom*. In such cases the Act confers upon the Income-tax Officer a wide authority to make a computation upon such basis and in such manner as he may determine. It may be remarked here that Sec. 13 does not deal with assessment itself and consequently no order of assessment can be made under this section. Secs. 14 to 16 of Chapter III deal with exemptions, and Sec. 17 empowers an Income Tax Officer to reduce a tax in certain circumstances.

Chapter IV is headed "Deductions and Assessment", and comprises Secs. 18 to 39. It will be seen that all those sections deal with actual assessment or questions arising from or relating to such assessment. Secs. 18 to 21 concern such matters as are not before us and may, therefore, be ignored. Sec. 22 is headed 'Return of Income'. Sub-Secs. (1) and (2) of Sec. 22 enjoin the various classes of assessees to submit returns by a prescribed date. Sub-S. (3), among other things, extends the time for the submission of a return. Sub-Sec. (4) empowers the Income tax Officer to serve a notice on the assessee to produce such accounts or documents as the said Officer may require. Sec. 23 is headed 'Assessment'. Sub-Sec. (1) of this section enjoins the Income-tax Officer to assess the total income of the assessee on the basis of the return furnished by him in case the said officer is satisfied that the return made by the assessee is correct and complete. If, however, the said return is not found to be correct or complete, sub-sec. (2) authorizes the Income-tax Officer to serve a notice on the assessee either to attend at his office or "to produce, or to cause to be there produced, any evidence on which such person may rely in support of the return". Then follows sub-sec. (3) which is the centre of controversy before us. This sub-section lays

down that "the Income-tax Officer after hearing such evidence as such person may produce and such other evidence as the Income-tax Officer may require, on specified points, shall, by an order in writing, assess the total income of the assessee, and determine the sum payable by him on the basis of such assessment". Sub-sec. (4) empowers the Income-tax Officer 'to make the assessment to the best of his judgment' in cases enumerated there. Out of the other sections in this Chapter, Secs. 27, 30 and 37 are the only sections which require consideration. Sec. 27 lays down that in certain cases the assessee may apply to the Income-tax Officer to cancel the assessment and empowers the Income-tax Officer to do so and to make a fresh assessment *in accordance with the provisions of Sec. 23*, if he is satisfied that the grounds urged by the assessee are sufficient. Sec. 30 provides for appeals against assessment in those cases among others, in which an assessee objects to the amount or rate at which he is assessed under Sec. 23 or Sec. 27 and Sec. 37 confers certain powers of a civil Court for certain specified purposes on the Income-tax authorities. It will thus appear that the only section under which the method of computing income for the purposes of Sections 10, 11 and 12 is provided for is Sec. 13 and the only section under which an assessment can be made, or in other words, the amount of rate at which an assessee is to be assessed is Sec. 23 and no other. To divorce, therefore, Sec. 13 from Sec. 23 or to consider that they occupy detached positions, one having no connection with the other, is to misappreciate the whole tenor of the income-tax law.

The Commissioner seems to think that the words 'method employed' as used in the proviso to Sec. 13 bear a restricted sense and consequently the second alternative in the proviso can be invoked only in those cases where there is a defect in the method itself apart from the accounts. On the other hand he places a very wide interpretation on the word 'assess' as used in sub-Sec. (3) of Sec. 23 and considers that the Income-tax Officer can by virtue of this term make a 'random assessment' in all those cases where the accounts are defective apart from the method. Counsel for the firm supports the Commissioner in so far as his interpretation of the words 'method employed' is concerned and contends that as the method employed by the firm had not been objected to before the Income tax Department, and has not been found to be defective in the present assessment, the proviso to Sec. 13 was out of the question. He, however, joins issue with the Commissioner on the interpretation of the word 'assess' as used in Sec. 23 (3)

and argues that as the proviso to Sec. 13 could not be brought into play, the Income-tax Officer was bound to give his decision on the evidence before him and could not make an estimate of his own without placing material on the record to support his decision. He founds his argument on the absence of any such language in Sec. 23 (3) in relation to the power of the Income-tax Officer, as is used in the proviso to Section 13 or Section 23 (4). In my view, however, this argument is fundamentally wrong. As already stated, the proviso to Sec. 13 is not excluded by Sec. 23 (3). On the other hand, it is always available to be utilized under Sec. 23 (3) whenever those circumstances arise which justify its use. It was not necessary for the Legislature to mention specifically in Sec. 23 (3) what an Income-tax Officer should do in case the assessee's evidence in support of his accounts is held to be unreliable, inasmuch as Sec. 13 had already made a provision for that contingency and it would have been obviously redundant to repeat in sub-Sec. (3) of Sec. 23 what had already been provided for in Sec. 13.

There is also no warrant for restricting the interpretation to be put on the words 'method employed' as used in the second alternative dealt with in the proviso to Sec. 13. In ordinary parlance these words convey the idea of 'the manner in which accounts are kept' and I see no reason to doubt that the same sense is conveyed here. If the accounts tendered by the assessee are found to be incorrect or incomplete, if they are 'cooked' or 'fictitious', it will not be wrong to say that the method of accounting is such that it is not possible to deduce the total income of the assessee therefrom. In my view, therefore, while making an assessment under sub-section (3) of Sec. 23, it is open to the Income-tax Officer to invoke the proviso to Sec. 13, if after examining the accounts produced by the assessee under Sec. 22 (4) or after recording the evidence led by the assessee under Sec. 23 (2), he still remains unconvinced as to the reliability of the assessee's accounts, and considers that they do not serve as a safe guide in calculating the assessee's taxable income.

In *Commissioner of Income Tax, Burma* v. *Chan Lo Chwan* three Judges of the Rangoon High Court held that where the assessee's accounts were not found to be genuine, the Income-tax Officer was under no obligation either in law or in common fairness to set out to the assessee all the reasons therefor, and could proceed to make an assessment upon materials, albeit insufficient. In the course of their judgment, the learned Judges remarked:—

"We quite fail to see why a party who has made a false return should be in a better position than one who has failed to make any return. Mr. Cowasjee urges that Sec. 13 only applies to the method and does not empower the Income-tax authority in any way. We cannot see any such limitation in the words of the proviso. . . . . In this case, the Income-tax Officer clearly considered that the income, profits and gains could not properly be detected from the respondent's statement, since he decided that the statement was not genuine. He was consequently entitled to adopt whatever method he thought best. Adapting the words of the Lord President in *Macpherson's case,* already alluded to, "if Chan Lo Chwan, (the assessee) does not choose to make an honest statement of account so that the amount of profits may be strictly determined, he cannot complain if a random assessment is made upon him by the Crown."

With these observations I am in respectful agreement and consider that this judgment lays down good law and interprets the proviso to Sec. 13 in the only correct manner possible.

The Commissioner has in this connection referred to an English case reported as *Anderson* v. *Commissioners of Inland Revenue* and remarked that 'it expressly separates questions of accounting method from question whether the accounts were cooked,' but apart from the fact that the language and requirements of the English Act are different, that decision does not help him in the least. It rather goes against him, as it was observed in that case that if the income-tax authorities had expressly stated that the accounts were unreliable, no interference with their estimate would have been called for. The LORD PRESIDENT remarked :—

"It may be they did find in fact that the books were badly kept, or that the profit and loss account had not been accurately made out; but if that is what they meant as a reason for refusing to look at what was undoubted evidence, they should have said so. There might then have been no difficulty whatever in sustaining their conclusion, which would have been to some such effect as this :—' The books and accounts you produce are not satisfactory for one reason or another. That being so, we cannot regard them as proving your profits.' LORD SANDS added "If the Commissioner had said that they thought the accounts were fictitious or 'cooked,' then that would have justified their disregarding these accounts, and in those circumstances, we might not have been justified in scrutinizing the grounds upon which they were proceeding and in considering whether they were sup-

ported by evidence which would satisfy a Court of law". LORD MORISON observed: 'In this case, the Commissioners have not made a statement to the effect that they were not satisfied with the statement of the profits which the appellant delivered to them" and on that ground he agreed to the case being remitted back to the Commissioners for their further consideration.

Further, even if it be assumed for the sake of argument that the word 'method' has been used in any restricted sense in the second alternative in the proviso to Sec. 13, in a case like this, where an Income-tax Officer rejects the assessee's accounts on the ground that he keeps no stock registers or vouchers or that he employs an inventory system only which is not conclusive in the matter of determining the true state of affairs, it cannot be said that he does not attack the method of accounting and can, therefore, make no use of the proviso to Sec. 13 in determining the taxable income. From whatever point of view one looks at the case, it passes one's comprehension why the proviso to Sec. 13 cannot be invoked in such cases in the rejection of an assessee's accounts.

It is true, as urged by the firm, that in Chapter IV of the Act, it is sub-section (4) of Sec. 23 alone that empowers an Income-tax Officer to assess to the best of his judgment and that, too, in case of default, but it does not follow that the absence of these words in sub-section (3) of Sec. 23 takes away the power vested in the Income-tax Officer by the terms of the proviso to Sec. 13. An assessment always follows the computation of income and if the computation of income for the purposes of assessment in certain circumstances lies in the discretion of the Income-tax Officer, he can, while disposing of a case under sub-section (3) of Sec. 23, compute the income in any manner that he deems best, when those circumstances exist, and assess accordingly. I am further disposed to think that the reason why the provisions of the proviso to Sec. 13 were not enacted in Sec. 23 itself or in the chapter relating to assessment was that Sec. 13 did not apply to three out of the six chargeable heads of income enumerated in Sec. 6, while Sec. 23 or for that matter the whole of Chapter IV was of general application and as Sec. 13 applied only to Secs. 10, 11 and 12, it was considered by the Legislature to be a convenient arrangement to insert it immediately after those sections. If the position maintained by the firm were accepted, it would lead to anomalous results, as in that case it would be impossible for the Income-tax Officer to disregard the accounts submitted by the assessee, however unreliable they might appear to be. It is pre-

posterous to say that even if the accounts are found to be fictitious or 'cooked,' the Income-tax Officer is bound to assess the author of those accounts on those accounts alone. In *Commissioner of Income Tax, Burma* v. *E. M. Chettiar Firm* (4 Rang. 239), the assessee had not submitted full accounts and the Assistant Commissioner had made his own estimate of the assessee's income and had enhanced the assessment. Three Judges of the Rangoon High Court upheld the order, remarking at the same time that it was not an order under Sec. 23 (4).

Counsel for the firm has strenuously contended that as the law allows the Income-tax Officer to examine evidence *suo motu* to rest the truthfulness of the accounts, he can come to his own finding only on the basis of the evidence so examined. I am not, however, prepared to hold that any burden is imposed on the Income-tax authorities to prove by 'positive evidence' that the accounts are unreliable or that the figure at which they assess is the correct figure. In the first place, the question of unreliability of accounts is a question of fact and primarily falls for the determination of the Income-tax authorities alone. If, therefore, it is once decided by them that the accounts are fictitious or unreliable, their finding cannot be disturbed unless, of course, it is altogether capricious and injudicial. Secondly, the Income-tax Officer cannot be fixed with the knowledge of the state of the assessee's account and cannot consequently be ex pected to lead evidence to prove the assessee's transactions for the accounting year. Under Sec. 106 of the Evidence Act, the onus of proving a fact always lies on the person within whose knowledge especially that fact is and it cannot be denied that it is the assesssee who is the person contemplated by this section.

I do not mean to say that an Income-tax Officer has a blank cheque to proceed in utter disregard of all judicial considerations. What I intend to convey is that in matters like these a very wide discretion vests in the Income-tax authorities in view of the exigencies of the case, an the control exercisable on them is very meagre. What alone has to be seen in such cases is whether the discretion has been judicially exercised and if it is once found to be so exercised, no Court can interfere with the order. In other words, a Court cannot replace its discretion for the discretion already exercised by a competent tribunal.

There are numerous Indian cases where neither the finding of the Income-tax authorities as to the falsity or incompleteness of

the assessee's accounts was disturbed nor was the estimate of assessment made by them in consequence thereof.

In *Narayan Atmaram Patkar* v. *Commissioner of Income-tax, Bombay*, a Division Bench of the Bombay High Court in a case where the Income-tax Officer had found that the income of the assessee could not be deduced from his books and had consequently made an assessment charging the assessee a fair rate of interest on the capital shown in his books, held that the computation was properly made under the proviso to Section 13.

In *Jewan Shah Maya Shah* v. *Commissioner of Income tax, Punjab*, a Bench of this Court remarked that the question of rejection of the accounts as unreliable was expressly reserved to the assessing Officer and consequently upheld an estimate made by him of the taxable income of the assessee.

In *Rochiram Khattar, In re*, again a case from this Court, on estimate of income made by the Income-tax Officer on the ground that the accounts were incomplete was maintained and approved.

In *Ibrahimbhai Mulla Badruddin* v. *Commissioner of Income tax, C. P.*, the learned Additional Judicial Commissioner of Nagpur upheld an assessment made on the basis of the personal experience gained by the Income-tax Officer from the working of their factories and refused to issue a mandamus to the Commissioner holding that no question of law was involved.

In I.L.R. 9 Patna 240 which went on appeal to their Lordships of the Privy Council (See *Commissioner of Income tax, Bihar and Orissa* v. *Sir Kameswar Singh* I.L.R. XII Pat. 318, P.C.; 1934 I.T.R. 94) it had been held that the question whether the assessee's accounts do or do not disclose his real income, is a question of fact, as to which the finding of the Commissioner of Income-tax is binding on the High Court. It was further observed that although, on the one hand, the amount at which an assessee's income is assessed must be based on evidence, on the other hand it is the duty of the assessee to keep such accounts as will show what his real income is, and on that basis the additions to the assessee's return made by the Income-tax Officer were upheld. Their Lordships of the Privy Council do not appear to have taken any exception to these remarks. On the other hand they have supported the action of the Income-tax Officer in adopting a method of his own under the proviso to Sec. 13 while disregarding the assessee's method adding only that the computation of the Income-tax Officer is not exempt from examination on appeal, and if it is found to be wrong, the assessment may be set aside.

In *Nathuram* v. *Commissioner of Income-tax, Punjab*, a Division Bench of this Court presided over by the Hon'ble the Chief Justice and MONROE J., observed :—" The argument placed before us for the assessee is that the books, which were arithmetically correct, were produced to the Income tax authorities and unless they could show that items in those books were incorrect, they were bound to accept the books; in other words, it was necessary for the Income-tax authorities to produce evidence or cause to be produced evidence before themselves showing that the statements in the books or some of them were false. We cannot agree with the proposition advanced by the learned counsel, though we do certainly agree with his contention that the procedure of the assessing authority is a judicial one and that he ought to act upon evidence. But, in our opinion, in a case such as this......he has the right to require a satisfactory explanation......and in the absence of a satisfactory explanation or if he receives an explanation which he cannot believe, the assessing Officer is entitled to regard the account as unsatisfactory.........That is all that has been done in the present case by the Income-tax Officer." It will appear that in that case circumstantial evidence was regarded as sufficient to support the conclusion arrived at by the Income-tax Officer.

In *Tarachand Pohumal* v. *Commissioner of Income-tax, Punjab*, which again is a case from this Court, the Income-tax Officer had added a sum of Rs. 10,000 to the income shown in the books as he had come to the conclusion that there were omissions in the accounts, the total value of which could not be accurately determined and that the accounts did not represent a complete and correct version of the actual business. While remarking that the Income-tax Officer should have proceeded on judicial principles, the existence of one omission was held to be sufficient by a Division Bench of this Court to justify the action taken by the Income-tax Officer.

In *Bhikhaji Vyankatesh* v. *Commissioner of Income-tax, C.P.*, the learned Judicial Commissioner of Nagpur held that the mere filing of a verified statement by an assessee and his statement on oath in support of it are not sufficient to discharge the onus which lies on him to prove the correctness of the return submitted by him. The onus is not under such circumstances shifted to the Income-tax authorities to disprove the correctness of the return.

Counsel for the firm has in this connection referred to *Pioneer Sports Ltd., Sialkot* v. *Commissioner of Income-tax, Punjab*

and *Jambudas* v. *Income-tax Commissioner*, but with all respect, I am constrained to remark, that those judgments have not viewed the question from a proper angle of vision.

In *Pioneer Sports Ltd., Sialkot* v. *Commissioner of Income-tax, Punjab*, a Division Bench of this Court has held that the mere fact that a company shows a low rate of profit was no reason for the Income Tax Officer to reject the total profits nor was the absence of a stock register, which the company had admittedly never used before, and that the use of the proviso to Section 13 for the purpose of introducing an arbitrary manner of computing the profits was not justified. In my view, this judgment proceeds on a wrong basis when it criticises adversely the reasons of the Income-tax Officer for rejecting the accounts. Whether the account books are reliable or not is a question of fact, to be determined solely by the Income-tax Officer, and when he gives reasons for doing so, which are not apparently capricious or injudicial, it is not possible to disturb his finding merely on the ground that the material in support of those reasons is meagre or insufficient.

In *Jambudas* v. *Income-tax Commissioner* the learned Additional Judicial Commissioner of Nagpur has observed as follows :—

"The Income-tax Department must always bear in mind that the normal presumption is in favour of good faith and not of bad faith on the part of the assessee. The applicant was, therefore entitled to ask the Crown to start with a presumption that the entry in the *Khata* was made in the ordinary course and with no intention to conceal the income, and it was for the Crown to prove the contrary. Suffice it to say at this stage that as the learned Commissioner does not seem to have approached the case from the right point of view of burden of proof, there is likelihood of the conclusions drawn by him being vitiated for want of proper appreciation of facts or for misapplication of the law to them. This Court can always test the soundness in point of law of the conclusions drawn from proved facts".

For this view, reliance has been placed on a quotation from a judgment of their Lordships of the Privy Council which reads as follows :—"The proper legal effect of proved facts is a question of law". I may say with all respect that the learned Additional Judicial Commissioner has misapplied this quotation in so far as to justify his interference with conclusions of fact arrived at from proved facts. Such conclusions are themselves questions of fact and not questions of law.

In *Queen* v. *Special Commissioners of Income Tax*, In re *Fletcher* (3 Tax Cas. 289 at pages 290 and 291) LORD ESHER observed: "It is a question of the true inference which they had to draw as a matter of evidence upon the facts which they had in evidence before them. But to draw an inference of fact from evidence before you is not a question of law at all. The inference is a question of fact just as much as the direct evidence of fact, and it would be an appeal against facts, which we are not entitled to entertain and consequently there can be no mandamus. . . . I say, if that is a question of fact, the mere question of whether they appreciated the evidence rightly or not, and whether they drew a right inference of fact, is not the subject-matter of a mandamus at all. There would be an appeal if there was an appeal, but there is none." So far as the jurisdiction of the Income-tax authorities under the provisions of the Indian Income-tax Act is concerned, the law is practically the same as in England. They are the judges of fact while this court is a judge of law and all those matters which are barred from the jurisdiction of the Courts in England are similarly barred here. The judgments relied upon by the firm therefore, do not render any help to the firm at all.

In his statement, the Commissioner has referred to certain English decisions, among others, *Stocks* v. *Sulley* (4 T. C. 98), *Tudor and Onions* v. *Ducker* (8 T. C. 591), *Hunt & Co.* v. *Joly* (14 T. C. 165), *Wall* v. *Cooper* (14 T. C. 552). Counsel for the firm has urged that those decisions are not strictly in point and can be of no avail in the determination of the question now before us, as the procedure under the English Act is to some extent different from the procedure prescribed under the Indian Act. This is no doubt so, but the general principle enunciated in those judgments, in my opinion, can be of some use in deciding who is the proper person to declare whether the accounts furnished by the assessee can be relied upon or not.

In *Stocks* v. *Sulley* the Commissioners held that they were not bound to act upon the evidence produced by the assessee and fixed a valuation of their own on the lease produced by him. The LORD PRESIDENT remarked that it is plain that the Commissioners were not concluded by the production of that lease, and that they were entitled to rely upon other competent sources of information in order to form the best judgment they could. In the same case, LORD ADAM observed: 'Now the Commissioners in considering that . . . did not disregard it but they did not treat it as

conclusive, and they were entitled in terms of the 63rd section to fix the assessment according to their own belief and judgment. And that is exactly what they did.'

In *Tudor and Onions* v. *Ducker*, the question for the opinion of the Court was whether, in the absence of evidence in support of the appeal, the Commissioners were right in confirming the additional assessments. ROWLATT, J., observed :—" These people have only attacked it by producing a certificate of a discredited accountant, saying it ought to be taken in spite of what had happened, and the Commissioners said : 'No we want evidence' and they did not get it, and therefore, they confirmed the assessments. I think they were right.

In *Hunt* v. *Joly*, the assessees, had delivered to the Inspector of Taxes balance sheets and trading and profit and loss accounts of their business and the Inspector asked that the accounts should be certified by a qualified accountant. On the assessee's refusal to comply with this requirement, an estimate was made by the Additional Commissioners which was far in excess of the return made by the assessees. ROWLATT, J., remarked :—

" Then what happened was that he (the Inspector of Taxes) was not satisfied. He was perfectly entitled not to be satisfied ; I cannot conceive why he should not be dissatisfied. It was not because he was raising a point of law, it was because he was saying ' I am not satisfied.' The matter goes before the Additional Commissioners and they are not satisfied. . . . . I cannot possibly try that question. These are gentlemen who are entrusted with the duty of fairly administering the law and if it had been said that they were merely masquerading, that they had been pretending to do their duty but that they arbitrarily and injudicially said : ' We will not listen to you. , . . . and we perversely decline' if that was the sort of case against them, of course I cannot try it here ; it would be impossible to try it here. If you want to say anything of that sort, you should go for mandamus against them to hear a point of law."

In *Wall* v. *Cooper*, the Commissioners refused to accept the accounts submitted by the assessee as satisfactory evidence and adjourned the proceedings on the assessee's undertaking to furnish accounts certified by an accountant. Such accounts were however not produced and the random assessment was confirmed. It was held that the question was one of fact which it was for the Commissioners to determine. Here again ROWLATT, J., made some pertinent remarks, which are reproduced below :—

"Somebody must decide whether the statements are wrong or not: I have no jurisdiction to do anything. Somebody must be the ultimate judge of every thing in this world. Questions of fact are decided by the Commissioners, and they have decided it. It may be unfortunate for you or not; but their decision ends the matter."

It will be obvious from the quotations reproduced above that very wide discretion vests in the Income-tax authorities to accept or not the accounts tendered by the assessee and that it is only in the case of capricious and injudicial exercise of that discretion that any question of law can be said to arise; otherwise their judgment is final.

This takes us to another question mooted at the Bar as to how far the proceedings before an Income-tax Officer can be called judicial proceedings and to what extent he is bound to conduct himself in the manner in which an ordinary court of law is expected to proceed. Counsel for the firm has referred to Sec. 37 of the Income-tax Act and contended that, to all intents and purposes, all proceedings before an Income-tax Officer under Sec. 23 (3) are judicial proceedings and that he is bound by all the rules of evidence which bind an ordinary Court. In this connection, he has mainly relied on *Baijnath* v. *Commissioner of Income Ta,x Punjab* (2 I.T.C. 176), *Dunichand Dhaniram* v. *Commissioner of Income Tax, Punjab* (I.L.R. 7 Lah. 201), *Muhammad Hayat* v. *Commissioner of Income Tax, Punjab* (5 I.T.C. 459), *Binjraj Hukamchand, In re* (5 I.T.C. 303), *Commissioner of Income Tax* v. *Bombay Trust Corporation* (A.I.R. 1936 P.C. 269) and *Gopinath Naik* v. *Commissioner of Income Tax, U.P.* (58 All. 200).

In *Baijnath* v. *Commissioner of Income Tax, Lahore*, the Commisssioner had, in the statement of the case submitted by him, remarked that if an assessee withheld evidence that he alone could furnish and on which alone an accurate computation of his income could be based, there was no way open to the Income-tax Officer but to make an estimate of his income and to base assessment on such materials as were available to him. On this, a very brief judgment was delivered by a Division Bench of this Court composed of Le Rossignol and Martineau, JJ., upholding the assessment. In the course of the judgment, however, the following observation was made:—

"We agree with the petitioner that the Income-tax Officer should be governed in his procedure by judicial considerations. He should base the assessment on legal and not mere hearsay evid-

ence, which may be the evidence of his officers or of members of the public, but without evidence that items which do not appear in an account should find a place therein, he is not entitled to assume on mere general hearsay that those items should appear in the account."

The case of *Dunichand Dhaniram* v. *Commissioner of Income Tax, Punjab*, was decided by the same Division Bench about the same time when the previous case was decided. There also the learned Judges observed that the proceedings of an Income-tax Officer were of a judicial nature and that the proviso to Sec. 13 did not justify him in estimating the income of the assessee arbitrarily, by guess work, or without indicating the basis of his assessment. They further remarked that the evidence produced by the assessee should be accepted unless rebutted by other admissible evidence and not by mere hearsay.

The case of *Muhammad Hayat* v. *Commissioner of Income Tax, Punjab*, was decided by five Judges of this Court and the principal judgment was delivered by Sir Shadi Lal, C. J. In the course of his judgment the learned Judge made the following remarks which, in my view, shake the authority of both the cases discussed above: "The proceedings taken by him (the Income-tax Officer) are not regulated by strict judicial principles, and he has sometimes to depend on materials which would be wholly inadmissible in a Court of Law. At the same time he cannot act in a purely arbitrary manner. It is true that a finding of fact recorded by him cannot be impeached even when it is not based upon any material, nor is it open to the High Court to say with respect to a particular case that the assessment has been made contrary to the rules of justice and good conscience. The High Court is, however, entitled to make a pronouncement upon the meaning of Sec. 23 (4) and to lay down that the Income-tax Officer cannot be said to make an assessment to the best of his judgment, if he is not guided by the dictates of justice and fairplay. An assessment resting upon the whim and caprice of the Income-tax Officer cannot be elevated to the dignity of an assessment made to the best of his judgment." It would be obvious from this quotation that the discretion vested in an Income-tax Officer in cases where he is entitled by law to make an estimate to the best of his judgment is fettered only by this consideration that it should be exercised in accordance with the dictates of natural justice. It is true that the same learned Judge in reference to Sec. 23 (3) observed :

" After he (the Income-tax Officer) has received the evidence produced by the assessee and also the evidence, if any, which he has himself called for on the points specified by him, he must assess the income on the material produced before him and has no right to make an assessment to the best of his judgment," but this remark, in my view, was not intended to apply to those cases where the proviso to section 13 had come into play.

In *Binjraj Hukamchand, In re,* Sir George RANKIN, C.J. observed :

" When as in this case an assessee produces his books for the year of account and complies with any other requirements as to specific documents so that he is assessed in the ordinary way under Sec. 23 (3) and not as being in default, the Income-tax authorities cannot assess him upon any figure of profits not warranted by evidence which they have before them." These observations, too like those made in *Muhammad Hayat's case* take no account of the proviso to Sec. 13.

In *Commissioner of Income-tax, Bombay* v. *Bombay Trust, Corporation* the following observations were made by their Lordships of the Privy Council which have been relied upon by the firm : " However sceptical the attitude which the income-tax authorities may think fit to adopt towards the declarations offered and the entries made in the Bombay Company's books, it is necessary, if the assessment made is to be supported, that there shall be some evidence to show that...The only rule of evidence to be discovered in the Indian Evidence Act having any bearing upon this question would appear to be illustration (d), Sec. 114, Indian Evidence Act...This rule cannot in the present case supply the want of evidence." These observations of their Lordships of the Privy Council, however, are not relevent to the present case, as their Lordships were not considering a case of unreliable accounts. Their Lordships have, in continuation of this passage observed as follows :—

" Their Lordships are not considering a case in which by reason of the entries in an assessee's books of account being inconsistent, or by reason of positive evidence showing that certain entries in his books are erroneous or fraudulent, the value of the books as evidence can be considered as overthrown." This quotation clearly indicates that, in cases of unreliable, inconsistent or fictitious accounts, an Income-tax Officer can disregard the books of account tendered by the assessee and proceed in any manner, that he deems best.

treat the Income-tax Officer fairly and lay the facts fully before him. The sooner it is understood that these are questions of fact, and questions of fact only, and that the slightest attempt to open the door to appeals to this Court on what are alleged to be mixed questions of law and fact, but are really only questions of a fair figure of assessment, must be discouraged, the better ".

In *Maharaja of Darbhanga's Case* (12 Pat. 318), their Lordships of the Privy Council upheld the action of the High Court in maintaining an assessment based on guesswork. The remarks made by the learned Chief Justice of the Patna High Court with which their Lordships agreed are quoted in the judgment and are contained in I.L.R. 9 Pat. 240 at pp. 270 and 271. The learned Chief Justice no doubt remarked that the Income-tax Officer was not entitled to make a guess without evidence but the evidence that was considered sufficient in that connection was the state of affairs in the previous years coupled with the fact that the assessee had a large mortgage loan business. This received the approval of their Lordships, who further observed: "If the assessee wished to displace the Taxing Officer's estimate, it was open to him to adduce evidence on all the purchase transactions during the year and of the financial results thereof which he apparently made no attempt to do."

In *Harmukhrai Dulichand, In re*, Sir George Rankin, C. J., observed as follows:—"It has been said that the Income-tax Officer must proceed in a judicial manner and Sec. 37 has been mentioned in this connection. Fundamentally, no doubt, the Income-tax Officer must proceed in a judicial spirit and come to a judicial conclusion upon properly ascertained facts, though I would point out that the Income-tax Officer is not a Court, he has not the procedure of a court, and he is to some extent a party or Judge in his own case . . . . . It is idle and absurd for a person who has books of account and deliberately withholds them to complain of not being treated in a judicial manner. The judicial manner is a manner which proceeds upon evidence, and the basis of the statute is to see that available evidence is produced. It is then and only then that the assessment is to be made upon a judicial consideration of the evidence. Otherwise it is to be made 'to the best of his judgment' and *brevi manu*". It may be remarked that in the present case, too, the Income-tax Officer had reason to believe that the firm had not produced certain account books which they possessed and this circumstance was used as one of the reasons for not placing reliance on the accounts submitted by the firm.

In *R.* v. *Special Commissioner of Income-tax, Elmhirst ex-parte* (52 T.L.R. 143), it was held that in making assessments and in dealing with appeals, the Commissioners are not in the position of Judges deciding an issue *inter pares* but are exercising a statutory authority and a statutory duty which is to assess or estimate the amount on which, to the best of their judgments, the subject ought to be taxed. The Master of the Rolls observed: "They are not in the position of Judges deciding an issue between two particular parties. Their obligation is wider than that. It is to exercise their judgment on such material as comes before them and to obtain any material which they think is necessary and which they ought to have, and on the material to make the assessment or the estimate which the law requires them to make".

In *Local Government Board* v. *Alridge* (1915 A.C. 120, at page 132) VISCOUNT HALDANE, L.C., defined the expression "acting judicially" in the following manner:—

"They must deal with the question referred to them without bias, and they must give to each of the parties the opportunity of adequately presenting the case made. The decision must be come to in the spirit and with the sense of responsibility of a tribunal whose duty it is to meet out justice. But it does not follow that the procedure of every such tribunal must be the same".

In the same judgment at page 137 LORD SHAW observed:—

"The judgments of the majority of the court below appear to me, if I may say so with respect, to be dominated by the idea that the analogy of judicial methods or procedure should apply to departmental action. Judicial methods may, in many points of administration, be entirely unsuitable, and produce delays, expense, and public and private injury. The department must obey the statute. . . . . and if administration is to be beneficial and effective it must be the master of its own procedure".

At page 138 his Lordship added:

"But that the judiciary should presume to impose its own methods on administrative or executive officers is a usurpation. And the assumption that the methods of natural justice are *ex necessitate* those of Courts of justice is wholly unfounded".

It is unnecessary for me to dwell further on the subject or to try to formulate the principles deducible from the judgments discussed above, as they come out clearly in the quotations themselves. Suffice it to say, that an Income-tax Officer is invested with plenary powers in the matter of assessment, and drastic though at first sight, these powers may appear to be, they are de-

signed to impress upon the minds of the assessees that if they expect equity from the Income-tax authorities, they must do equity themselves and come with clean hands before them.

My conclusions, therefore, are:—

(1) That both the Commissioner and the firm are wrong in thinking that the proviso to Section 13 is not meant to be applied to the rejection of the accounts in a case like this, where accounts are found to be unreliable or fictitious;

(2) that the proviso to Section 13 can be utilized in computing the income of the assessee when on weighing the evidence produced under Sec. 23 (3), the finding of the Income-tax Officer is adverse to the assessee;

(3) that under the terms of the proviso, the Income-tax Officer is the only proper person to decide whether the accounts are such as reflect the true income of the assessee, and if he holds the contrary, he is at liberty to compute the taxable income of the assessee upon such basis and in such manner as he may determine;

(4) that the proceedings before the Income-tax Officer are not judicial proceedings in the sense in which this term is ordinarily used, and that all that is required of him is to proceed without bias and give sufficient opportunity to the assessee to place his case before him, or in other words, to conduct himself in accordance with the rules of justice, equity and good conscience; and

(5) that the control exercisable by the High Court on the Income-tax Officer in these circumstances is slight.

Counsel for the firm has finally urged that in view of the fact that the question as formulated by the Court issuing the mandamus leaves us no choice to determine any other aspect of the case but that envisaged in the question we are bound to give a reply to the question but within the terms of the question. I may say at once that I do not consider that the proposition advanced by the counsel is legally sound. Under sub-section (3) of Sec. 66, the High Court, if not satisfied of the correctness of the Commissioner's decision, is empowered to require the Commissioner to state the case and to refer it. It is nowhere laid down that a question is to be formulated by the Court issuing the mandamus. Further, sub-section (5) of the same section lays down that upon the hearing of any such case the High Court is empowered to decide the questions of law raised thereby. This sub-section also does not confine the High Court to the decision of the question of law as formulated by the Commissioner or the Court issuing the mandamus.

On the other hand, it confers upon it full power to decide the question of law in the form it actually arises from the statement of the case made by the Commissioner. If any authority is needed for this proposition, reference may be made to *Shiva Prasad Gupta, In re.* In my view, therefore, it is competent to this Court to clarify the issue of law involved in the statement of the case made by the Commissioner and to give its considered opinion on the question really at issue. Not to do so would amount to a refusal to do its duty.

The principal point for consideration before us is, whether the present assessment based on estimate is justified, and although the Commissioner has defended it on grounds other than the proviso to Sec. 13, it is open to us to justify it on the basis of the said proviso. I have already expressed an opinion that the said proviso can be applied to a case like this and would consequently hold that the Income-tax Officer was justified in law in making an estimate of his own. It only remains to consider whether the estimate is fair. In doing so, we have to examine the basis on which and manner in which this estimate has been made. The Income-tax Officer has taken into consideration the state of affairs in general and the fact that the firm has a large business. The firm was given ample opportunity to support its version but it failed to produce any material on the record to enable the Income-tax Officer to arrive at a definite figure. In these circumstances, as remarked by their Lordships of the Privy Council, in *Maharaja of Dharbhanga's case* the onus lay on the firm to displace the estimate. Not having made any attempt to do so, it should suffer. I would, therefore, uphold the estimate.

This being so, the question of the flat rate need not detain us long. The Income-tax Officer had enough material before him to fix the amount and it cannot be said that the amount fixed by him is unfair.

Keeping in view the real question at issue and the discussion made above, I would answer the question in the negative. I would, however, make no order as to costs as the position adhered to by the Commissioner was obviously wrong.

COLDSTREAM, J.—I agree.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

SPEDDING, DINGA SINGH AND CO. *v.* COMMISSIONER OF INCOME TAX, PUNJAB.

COLDSTREAM and DIN MOHAMMAD, JJ.

May 18, 1937.

FOREIGN PROFITS—LEASE OF FOREST IN NATIVE STATE—TREES SOLD PARTLY IN STATE AND PARTLY IN BRITISH INDIA—PROFITS MADE IN NATIVE STATE, WHETHER TAXABLE IN BRITISH INDIA—IMPORTING TREES TO BRITISH INDIA, WHETHER AMOUNTS TO REMITTANCE OF PROFITS—PRESUMPTION—STOCK IN TRADE AND PROFITS—DISTINGUISHED—INCLUSION OF FOREIGN PROFITS IN ACCOUNTS KEPT IN BRITISH INDIA, EFFECT OF—INDIAN INCOME TAX ACT (XI OF 1922), Sec. 3 (1).

The assessee, a firm registered and having its head office at Lahore, took leases for felling timber from the Kashmir forests. In the year of account the assessee made a profit of more than 3 lakhs of rupees by the sale of timber in British India and a profit of Rs. 67,095 by the sale of timber in Kashmir. The profits in British India were assessed. There was a remittance of Rs. 37,000 from Kashmir to Lahore but the Commissioner found that this was not a remittance out of profits. The entire profits made in Kashmir were however assessed in British India on the ground (i) *that the Kashmir profits had also been brought into the accounts kept at Lahore, and* (ii) *the assessee had not disproved the presumption that the timber brought into British India comprised the available Kashmir profits. On a reference by the Commissioner*: Held, (i) *that the fact that the Kashmir profits were distributed among the partners in the firm's account books kept in British India was not by itself proof that those profits were received in British India*; (ii) *that there was no presumption that the timber received by the firm comprised the available profits of Kashmir; on the contrary the evidence established that what was received in the shape of timber was capital; and the profits made in Kashmir were not therefore taxable in British India.*

COLDSTREAM, J.—*Timber or its market value was not profits but only an element in the process of the production of the profits; the profits accrued and were ascertained not by the bringing of the timber into British India but by the selling of it.*

Cases referred to:

CALIFORNIAN COPPER SYNDICATE *v.* HARRIS [1904] (5 Tax Cas. 159).

CHIDAMBARAM CHETTIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS [1936] (A.I.R. 1936 Mad. 776; 1933 I.T.R. 309; 9 I.T.C. 41; I.L.R. 59 Mad. 263).

SCOTTISH MORTGAGE CO. OF NEW MEXICO *v.* MC. KELVIE [1886] (2 Tax Cas. 165; 24 Sc. L.R. 87).

SCOTTISH PROVIDENT INSTITUTION *v.* ALLEN [1903] (4 Tax Cas. 409; 38 Sc. L.R. 683; 3 F. 874: on appeal 1903 A.C. 129; 4 Tax Cas. 591).

STANDARD LIFE ASSURANCE CO. *v.* ALLAN [1901] (4 Tax Cas. 446; 38 Sc. L.R. 628).

MARTIN'S CASE (KNEEN *v.* MARTIN) [1935] (19 Tax Cas. 33; 1935, 1 K.B. 499; 104 L.J.K.B. 361; 152 L.T. 337).

Case stated by the Commissioner of Income Tax, Punjab and N.W.F. and Delhi Provinces, under Sec. 66 (2) of the Indian Income Tax Act in the matter of the assessment of Messrs. Spedding Dinga Singh and Co., for the year 1933-34. [Civil Ref. No. 2 of 1937].

The facts are stated in the judgment.

J. G. Sethi and *M. L. Sethi* for the Assessees.

J. N. Aggarwal and *S. M. Sikri* for the Commissioner of Income Tax.

JUDGMENT.

COLDSTREAM, J.—This is a reference by the Commissioner of Income Tax, Punjab, Delhi and North West Frontier Provinces, under Sec. 66 (2) of the Indian Income Tax Act, 1922. The circumstances leading to the reference are as follows:—

The assessee is a firm registered in Lahore as Spedding Dinga Singh and Company. The firm takes leases of forests in Kashmir and elsewhere, fells trees marked for it by the forest authorities and sells the timber. We are concerned at present with the assessment of profits arising out of two leases in Kashmir, one of the Lolab forests and the other of the Kamraj forest. Some of the timber is sold in Kashmir, part of the profits being utilised locally for further extraction expenses, but the greater part is floated down the Jhelum river and sold at the firm's depot at Jhelum in the Punjab.

The working expenses are remitted from British India, the firm's head quarters being at Lahore during the winter when very

little work is done in Kashmir. The Jhelum depot is financed from Lahore also. Accounts are kept in Lahore in the winter but the books are taken to Srinagar in Kashmir in the summer, where some or all of the partners spend the hot weather.

During the accounting period with which we are now concerned, July, 1931 to June 1932, the firm made a profit of more than three lakhs in British India and Rs. 67,095 in Kashmir. There is no dispute about the assessment of the profits in British India. The contest is about the Kashmir profits, which the Commissioner of Income-tax has taxed holding, on the reasoning made clear below, that the whole of these profits were received in India.

The amount assessed to tax by the Income-tax Officer in the first instance included a sum of Rs. 20,102 in addition to the ascertained profits of the firm arising in British India. The Income-tax Officer calculated this sum as follows: He found that Rs. 11,17,765 had been remitted to Kashmir to cover working expenses including royalty payable to the Kashmir State, and that the timber imported had been sold at Jhelum for Rs. 11,00,867. At a time when there was money in excess in Kashmir a sum of Rs. 37,000 had been sent from there to British India (Lahore) to clear or help to clear a bank overdraft. Adding this sum to the sale price of the timber he found that there had been remittances to British India to the value of Rs. 11,37,867. This amount exceeded the amount remitted to Kashmir for working expenses by Rs. 20,102 and assuming that the difference, which he called 'inwards excess,' represented profits brought into British India he added the sum to the profits admittedly made in British India and liable to be taxed.

The assessee appealed. The contentions urged were that the cash remittance of Rs. 37,000 was not a remittance of profits, the money having been sent to India to repay capital borrowed and that in computing the difference between the 'outward' and 'inward' remittances regard should be had to the cost price of the wood sold and not its sale price. The Assistant Commissioner issued notice to the assessee to show cause why the whole of the Kashmir profits should not be assessed to tax. After considering the assessee's arguments his conclusion was that the whole of Rs. 67,000 was profits brought into British India, because (1) the purpose for which the sum of Rs. 37,000 was brought into India and used was not a test of its being or not being profits, (2) because the timber brought into India represented a remittance of profits equal to the amount for which it was actually sold and (3)

because all the profits of the business, including the Kashmir profits, had been brought into the accounts kept in Lahore where control of the whole business was centralised and had been allocated to the partners as their profits.

On a further appeal to the Commissioner it was again argued for the assessee that the remittance of Rs. 37,000 was not a remittance of profits, that the distribution of the profits of the business in accounts kept in Lahore did not prove the receipt of the comprised profits at the place of account, that there was no "excess inwards" because regard should have been had to the cost price and not the sale price of the timber brought into British India, which cost price was shown by the accepted accounts to have been less than the cost price calculated by the Income-tax Officer, that in any case the timber imported was not profits imported but capital, and that the Kashmir profits were not ascertained when the timber was brought into British India.

During the hearing of the appeal the Commissioner asked the assessee to furnish further figures. From his appellate order it appears that what he asked for were figures showing the remittances sent to Kashmir for working expenses as distinct from the money sent to the forest managers from the Kashmir office. The figures were sent to the Commissioner by the assessee's auditor who, in a covering letter dated 14th May 1936, a portion of which is quoted in the Commissioner's order of reference (appendix paragraph 7) noticed that the figures showed an apparent inward excess of about a lakh in the difference between outward remittances from British India and the cost price of the timber brought into British India, which was taken to be Rs. 8,34,000. From the figures supplied the Commissioner concluded and (this is common ground) that the remittances from British India to Kashmir amounted to Rs. 7,37,488. On these figures the excess inwards was *prima facie* Rs. 96,512.

Here I may mention that the figure Rs. 8,34,000 was calculated by deducting Rs. 2,66,000 (approximately, the exact figure being Rs. 2,66,587) which was the admitted amount of the profits made by the sale of Kashmir timber in British India, from the sale price of the timber Rs. 11,00,000 (exactly Rs. 11,00,867). There is no dispute, I may add, about the figures, although as will be made clear hereafter, the assessee's case is that Rs. 8,34,000 included working expenses incurred in British India which ought to have been deducted in order to arrive at a correct estimate of the cost price of the timber when it came into British India.

Commissioner dismissed the appeal. His order is not throughout easy to follow. It seems however that he accepted the assessee's contentions that the distribution of profits in the head office accounts did not by itself imply a receipt of those profits in British India and that in calculating excess inwards or outwards it was the cost price of the timber and not its sale price that should be considered. It also appears that he did not accept either the Income-tax Officer's assessment or the assessment by the Assistant Commissioner as having been made on a proper basis. His conclusion he expressed as follows:—

"Receipts in British India were in excess of the available profits Rs. 67,095. The assessee has failed to establish that what was received did not include those profits, therefore it must be held to include them and they are assessable".

At the same time in view of "the nature of the enhancement practically as a new basis intact", he expressed his willingness to refer the case under Sec. 66 of the Income-tax Act not only in respect of the enhancement but so as to cover the whole amount.

The assessee petitioned the Commissioner asking for a reference under Section 66 (2) formulating two questions:

1. Whether as a matter of law it was impossible to find that the assessee's evidence had not disproved the presumption that the cash and monies' worth which he received in British India from Kashmir comprised the available Kashmir profits amounting to the agreed figure assessed?

2. Whether in the circumstances of the case any presumption arises that any profits were received in British India?

The Commissioner drafted a statement accordingly reversing the order of the questions proposed. To this statement the petitioner's counsel took objections in a letter addressed to the Commissioner. The Commissioner after hearing Mr. Sethi refused to entertain the objections but added to his statement an appendix incorporating this letter and giving his reasons for rejecting the objections. Counsel's submissions were that the figures on which the Commissioner had relied in estimating the cost price of the timber for the purpose of deciding whether there had been an 'excess inwards' were incomplete. It was explained that included in the cost price of the timber at the date of its sale was a sum of Rs. 1,22,000 which had been spent in British India on working expenses at the Jhelum depot, that the cost price of the timber when it entered British India was, therefore, not Rs. 8,34,000 but Rs. 8,34,000 minus Rs. 1,22,000 or Rs. 7,12,000, that is to say

considerably less than the remittances from British India to Kashmir which remittances according to the auditor's figures, accepted by the Commissioner amounted to Rs. 7,37,488. The letter also asked that the facts and figures given by the auditor in his letter of the 14th May might be printed. This request the Commissioner has refused.

Before us assessee's counsel while conceding that there is good authority for the proposition that where money, or something equivalent to money, that is to say, something which can forthwith be used as an ascertained sum of money, is remitted to British India from a foreign country where a firm does business, and profits are available in that country, and the onus lies upon the person denying that the remittance is of profits to prove his case, contends in the first place that no presumption arises that stock in trade brought into India by a firm whose normal business is investing in a commodity, importing it, and selling it, is profit, and in the second, that the evidence finally accepted by the Commissioner proves positively that no part of the Rs. 67,000 profit in Kashmir was received in British India, the timber received being merely stock in trade, the profit made by selling which has been taxed in India.

Before proceeding further, it is necessary to notice the following facts.

The assessment in this case is based on the assessee's accounts which have been accepted as " duly and properly maintained ", and not one based on an estimate of profits made under the provisions of Section 13 of the Income-tax Act nor one made to the best of the Income-tax Officer's judgment under Section 23 (4). Parties agreed that the figures adopted by the Commissioner may be assumed to be correct and nothing turns upon their accuracy so far as we are concerned. Again it is not suggested that any part of the Kashmir profits has been brought into India by any of the partners. The partners put in an affidavit to this effect and the truth of it has not been questioned by the Commissioner. It is true that the Commissioner in his order under Section 32 (see para 8) appears to have rejected the assessee's argument that the remittance of Rs. 37,000 could not be a remittance of profits because it was used or mostly used to pay off a bank over-draft, but he has not taxed that remittance; what he has taxed is not this sum or any other particular item of the accounts but a sum which in his view was represented by or comprised in the timber imported for sale and he has done so only,

so I understand, because, he believed it probable that the value of that timber exceeded the remittance outwards by more than the available (although at that time unascertained) profits in Kashmir. That this is so is obvious from his statement of the case where he remarks that he attaches no particular significance to this 'back remittance'. See also para 2 at page 2 and para 10 of his printed order under Section 32. It is admitted by counsel for the Income Tax Commissioner that it is to the remittance of Rs. 37,000 that the words 'back remittance' refer. Much more than this sum, I may note, was subsequently remitted to Kashmir for working expenses and we may take it that so far as this sum is concerned the assessee ultimately discharged to the satisfaction of the Commissioner the onus of proving that it was not a profit received in British India.

Having cleared the ground with these observations I return to the Commissioner's statement and objections pressed on behalf of the assessee.

That the Commissioner was entitled in the absence of any proof to the contrary to presume that the remittance of Rs. 37,000 was a remittance of profits is, as I have already indicated, not disputed, but as the Commissioner has made it clear that he does not now base his assessment on such a presumption the question whether the presumption arose in respect of this remittance becomes immaterial. In view of the final acceptance of the assessee's case (and I think that the language of the statement justifies the assumption that he has accepted it) that the remittance was merely a temporary transfer of capital the answer to the first question so far as it relates to the Rs. 37,000 should be 'no'.

For the proposition that there is a legal presumption in the circumstances of this case that the timber imported comprised all available profits in Kashmir I know of no judicial authority.

That the timber was stock in trade seems to be admitted by the Commissioner (paras 10 and 18 at page 10) and how such a presumption can attach to what is admittedly stock in trade by the sale of which profit has not been, but is hoped to be, made I find difficult to comprehend. The rulings cited by counsel for the Income Tax Commissioner in support of the Commissioner's proposition that until it is shown that stock in kind imported is not profit it must be presumed to be profit, even if there is no evidence that it is profit, do not appear to me to have any bearing on the point, dealing as they do with cases in which what is brought in is

either money or securities or something which can take the place of money.

No doubt profits can be received in forms other than money; they can be in the shape of goods, but the rulings cited nowhere lay down that imported stock in trade is to be taxed as profits unless it is proved that it is not profits. We are dealing here, it is to be remembered, with undisputed facts and figures, not with a case where facts have been concealed or accounts found unsatisfactory. I would accordingly answer the first question so far as it relates to the timber also in the negative.

This brings us to the second question referred to us. Whether in this case profits were imported is no doubt a question of fact but our judgment is asked upon it and I have no doubt that we are at liberty to examine whether there was any evidence before the Commissioner to support his conclusion that the cash and monies' worth received by the assessee in British India comprised the available Kashmir profits amounting to Rs. 67,095 and whether this conclusion could be based on any legal presumption drawn from the admitted or proved facts: see *Scottish Provident Institution* v. *Allan* (4 T.C. 409 at page 416).

In view of the Commissioner's finding as to the remittance of Rs. 37,000 it is unnecessary to consider the question so far as it concerns that remittance, for as I have made clear, that sum has not been taxed as profits received. What has been taxed is an unascertained portion of the value of the imported timber, it having been presumed that the timber represented at least Rs. 67,000 of profits made in Kashmir.

The Commissioner's decision in his order under Sec. 32 that the timber imported comprised the Kashmir profits was based partly on the evidence of the accounts showing that the cost value of the timber when it came to British India exceeded the amount of the remittances to Kashmir and showing that the Kashmir profits were distributed among the partners in the account books in British India, partly on the contents of the Auditor's letter of the 14th May 1936, and partly on a purely theoretical presumption that because the timber was worth more than the Kashmir profits (Rs. 67,000) and the assessee had failed to establish that its value did not include those profits—those profits are assessable as received in British India.

In his statement of the case which is before us, of which the appendix must, I think, be regarded as an integral part, the Commissioner first seeks to justify his order under Sec. 32 on the

ground that the full facts were not before him when he passed the order, while there was, on the other hand, an admission by the auditor that there was an inward excess of nearly a lakh of rupees. Then, in his appendix, having acknowledged that the auditor's admission was erroneous,he refused to reconsider the case because the assessee's petition asking for a reference to be made to this court did not set forth the specific contentions in which he has in the end apparently found some force.

We are not sitting as a superior Court dealing with an appeal against the order under Sec. 32 and we have to give our decision on the merits of the case now laid before us in the statement of the case including the appendix.

It is argued by counsel for the Income Tax Commissioner that the Commissioner's decision as to there having been an "excess inwards" is one of fact which cannot be questioned here. This is correct so far as the order under Sec. 32 is concerned. When the case came before the Commissioner on appeal no attempt, it seems, was made to bring it to his notice that a sum of Rs. 1,22,000 which was included in the "cost price" (Rs. 8,34,000) of the timber at the time of its sale in Jhelum had been supplied to the Jhelum depot from Lahore, and that the real "cost price" of the timber when it was brought into British India was therefore not Rs. 8,34,000 but Rs. 7,12,000 a sum less than the amount accepted by the Commissioner as representing the remittances outwards. Moreover, the Commissioner had before him the auditor's letter which admitted that on the assumptions that Rs. 7,37,488 had gone out, and that timber to the cost value of Rs. 8,34,000 had come in, there was *prima facie* an inward excess of approximately Rs. 96,500. We have it from the Commissioner's statement of the case (para 7 of the appendix and see also para 26 (2) of the order under Sec. 32) that while he was aware that some expenditure had been incurred at headquarters and at the Jhelum Depot, no reference had been made to this depot in any part of the complete audited accounts. It is clear, therefore, that when he dealt with the case under Sec. 32, he had material for his conclusion in the Auditor's letters and the accounts before him. But he has now conceded that the Auditor's admission was erroneous, and accepted as true the firm's figures showing that Rs. 1,22,000 were spent on the timber in British India and that therefore there was not an 'excess inwards' of Rs. 96,000 (para 7 of the appendix). In his statement he goes on however, to remark "This does not enable me to say that there

was not an excess inwards or to say what the excess really was." But if the admission in the Auditor's letter be excluded, what evidence is there that there was an excess? I can find none and neither can counsel for the Income Tax Commissioner. It is remarkable that, even in his order under Sec. 32 the Commissioner himself, somewhat inconsistently, discounts the importance of the question whether there was or was not any excess (para 23—" Thus, I look on the " excess " detail as only one of the various considerations in evidence in support of the assessee's attempt to show that what came did not comprise profits.") And that in the beginning of his order he makes it quite clear that the conclusion as to what the excess was is not based on any evidence other than the Auditor's admission (para 2 at page 2). He did not " find it necessary to come to any finding of what the respective outwards and inward totals were." It seems obvious, then, that if the assessee's figures are correct (the Commissioner has accepted them and their genuineness is not disputed before us) and the admission by the auditor is found erroneous, there is no material left for the conclusion that there was an excess inwards. The question of the value, as evidence, of the material in the shape of the admission (before the admission was discovered to be erroneous) is not, I think, open to us for consideration, but I am constrained to observe that it is difficult to see why the auditor's remark should in any way estop the assessee, as the Commissioner appears to hold that it does, from implementing his statement with further true details. It was not known, when the auditor wrote his letter, on what " new basis intact " the Commissioner was about to assess the tax. As a matter of fact the auditor's ' admission ' (he was not examined about this) was simply that between the totals of the outward remittances (Rs. 7,37,488) and the cost price of the timber at the date of sale (Rs. 8,34,000) there was an apparent inward excess of more than Rs. 96,000 and this fact could never be denied.

It follows that as the case submitted stands there is no evidence proving that there was an inward excess.

The fact that the Kashmir profits were distributed among the partners in the firm's account books in British India is not by itself proof that profits were received in British India. For this proposition there is ample authority and, as I have already noticed the Commissioner himself does not dispute it.

The only other ' material ' relied on by the Commissioner for his decision that this imported timber comprised the Rs. 67,000

Kashmir profits is the fact that the assessee failed to show that it did not do so. This brings us back to the question whether there was a legal presumption against the assessee. My view is that there was none. On the other hand, the evidence establishes the assessee's case that what was received in the shape of timber was capital. The Commissioner has admitted that it was stock in trade.

None of the rulings to which our attention has been drawn by counsel for the Income Tax Commissioner dealt with a case on all fours with the present case. That on which reliance has been mainly placed is the *New Mexico case*, *Scottish Mortgage Company of New Mexico* v. *McKelvie* (2 Tax Cases 165). But I find no feature in common between that case and the present one, in which there has been no conversion of money received in one country as capital into an equivalent for interest on investments in another. The profits stayed in Kashmir. No use was made of them in British India and the Rs. 67,000 was not made a debit entry in the Lahore books. *Standard Life Assurance Co.* v. *Allan* (4 T. C. 446), the next case cited, appears to me to go against the Commissioner. No doubt it was remarked in his judgment by Lord Trayner (p. 457) that it is not necessary that what is brought in must be *in forma specifica* before it can be treated as profit for purposes of income-tax and these words are authority for the proposition that profits may be received in other forms than in cash. But the question still remains whether this profit of Rs. 67,000 was brought into India in the shape of timber. Nor can I see how the judgment in *Californian Copper Syndicate* v. *Harris* (5 T.C. 159) referred to by Counsel for the Income Tax Commissioner helps him. That merely decided that where there is a company whose business is the organising and selling of mining property, and a sale of such property is made at a profit, the price being received in shares, the difference in the exchange is assessable to income-tax. *Chidambaram Chettiar* v. *Commissioner of Income Tax, Madras* (A.I.R. 1936 Madras 776) has also been cited but that case is not to the point here, the question there having been simply whether money in the shape of house-sites was received in a particular year. Pressed to its logical conclusion the Commissioner's decision would appear to justify the assessment to tax of a sum equal to the value of all the timber imported. He has not, however, assessed the tax on this basis and he has deliberately declined to estimate what proportion of the value of the timber represented profits. Once it was found that the timber

was capital and that the account did not prove an inward excess, the onus lay on the department to satisfy itself as to what amount, if any, of the timber represented profits. But having no evidence to go upon the department could not do this. The Legislature makes taxable only gains, profits and income and nothing else (see *Martin's case* 19 T.C. 33) and what we have to decide in this case is simply whether the timber or its market value, was as a fact profits. Can it be said on the evidence that the timber in this case was the produce of carrying on the assessee's business, and not merely an element in the process of production? I think not. The case might have been different if as soon as it came into British India the timber had been allotted forthwith to the parters of a syndicate whose object had been, say, simply the purchase of timber at a cheap rate, but the business of the assessee is not the acquisition of timber but the sale of it and the profits of the business accrue and are ascertained not by the bringing of the timber into British India but by the selling of it. The profits thus made by the assessee have been duly taxed.

I may add that there is no evidence, nor is it the case put forward for the Income Tax Commissioner that any part of the Rs. 67,000 profits was invested in this or any other timber imported into British India.

My conclusion is that the second question should be answered in the affirmative. The Income Tax Commissioner will pay the costs of this reference.

Din Mohammad, J.—In my view, the questions propounded by the Commissioner are not happily worded. As these questions stand, they appear to me to be inter-dependent. If, for instance, the answer to question No. 1 be in the negative, question No. 2 does not arise. Question No. 2 pre-supposes that there is in existence as a matter of law a presumption that the cash and money's worth which the assessee received in British India from Kashmir comprised the available Kashmir profits and that that presumption was indisputable and undisputed. This, however, is not the case. The assessee in suggesting question No. 1 joined issue with the Commissioner on the existence of this presumption and in my view, therefore, the principal point for determination is, whether in the circumstances of the case before us, it is possible to raise a legal presumption against the assessee that what he received in British India in the shape of saleable timber, was as a whole or in part profits, gains or income, liable to be assessed to income-tax. This

is what question No. 1 seeks to decide. Whatever is laid down in other decided cases and however permissible the presumption may be in different circumstances, I am definitely of opinion that on the facts of the present case, it is not possible to hold that such a presumption arises. The Commissioner himself has stated unequivocally that he attaches no importance to the cash remittance of Rs. 37,000. In sub-para 1 of para 10 of the appellate order, he says:

"As below I do not think the cash really comes into any separate consideration. If it stood alone in the middle of a year with general cash consignment outwards, nobody would imagine that it represented a drawal of profits".

In sub-para 2 of the same paragraph he even admits that "if what is sent can be specifically identified as a discrete slab of original capital, then even though profits were there and could have been taken it cannot be found that the remittance was of profits". In the face of these statements, it cannot be said that the legal presumption envisaged in the first question could arise in this case. As I take the facts of the case to be, the presumption is just the other way. The second question, therefore, does not arise, but, if it arose for the sake of argument, I am at one with my learned brother COLDSTREAM, J., that it should be answered in the affirmative.

Reference answered.

[IN THE HIGH COURT OF LAHORE.]

DITTURAM IDAN

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

COLDSTREAM and DIN MOHAMMAD, JJ.

April 28, 1937.

BAD DEBT—BURDEN OF PROOF—REFERENCE—QUESTION OF LAW—PROPER MODE OF STATING QUESTION—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 66 (3).

Where the assessee claimed certain deductions on the ground that they represented irrecoverable loans and the Commissioner referred the question "whether the above claims were established by evidence so cogent that as a matter of law it was impossible for the Assistant Commissioner not to hold them proved':

Held, *that the proper form in which a question of law arising in such cases can be put is "Whether the Income Tax Commissioner was upon the evidence obliged in law to allow the deductions and if not, whether he has in arriving at his decision departed from or misapplied the principles which in law govern the matter."*

Held also, *that where an assessee claims a deduction on account of the irrecoverability of a certain loan the onus lies upon him to prove that the loan had become a bad debt in the year of account.*

Cases referred to:

BINJRAJ HUKAMCHAND v. COMMISSIONER OF INCOME TAX, BENGAL [1931] (5 I.T.C. 303; 58 Cal. 1446; 35 C.W.N. 599).

COMMISSIONER OF INCOME TAX v. SIR S. M. CHITNAVIS [1931] (6 I.T.C. 453; 28 N.L.R. 205; 137 I.C. 772).

Case stated by the Commissioner of Income-Tax, Punjab, under Sec. 66 (3) of the Indian Income Tax Act (XI of 1922). Civil Reference No. 12 of 1937.

D. N. Aggarwal for the petitioner.

S. M. Sikri for *J. N. Aggarwal* for the Commissioner.

JUDGMENT.

This is a reference under sub-section (3) of Sec. 66 of the Indian Income Tax Act. The facts bearing upon the question of law involved in this case are very simple. The firm Dittu Ram Idan submitted a return under Sec. 22 of the Income Tax Act and claimed certain deductions from the profits shown in their accounts, on the ground that those deductions represented irrecoverable loans. The Income-tax Officer however, disallowed their claim and the Assistant Commissioner on appeal agreed with him. The Commissioner refused to refer the case under sub-section (2) of Section 66 on which a mandamus was issued by this Court requiring the Commissioner to state the case on the question which was formulated in the following terms:

"Whether there was any material for the finding as regards items (e), (i) and (m) as set out in the appellate order."

In the statement of the case submitted by the Commissioner he has suggested that the question should be amended as follows:

"Whether the above three claims were established by evidence so cogent that as a matter of law it was impossible for the Assistant Commissioner not to hold them proved."

In a similar case reported in *Binjraj Hukumchand* v. *Commissioner of Income Tax, Bengal,* SIR GEORGE RANKIN, C.J., in concurrence with his two colleagues, altered the form of the question in the following manner :

" Whether the Income Tax Commissioner was upon the evidence obliged in law to allow the deduction and if not whether he has in arriving at his decision departed from or misapplied the principles which in law govern the matter ? "

We consider that the form proposed by Sir GEORGE RANKIN is the only proper form in which a question of law arising out of such cases can be put and as it is open to this Court to decide the questions of law arising out of the case submitted by the Commissioner and as in our view this is the only proper question which arises out of it, we propose to decide the question of law in the form in which the question had been formulated by Sir GEORGE RANKIN in *Binjraj Hukamchand's case.*

Item No. (e) involves a sum of Rs. 2,232 said to have been due from one Nizam-ud-din. This item was rejected by the Income Tax Officer on the ground that the item did not represent an irrecoverable loan but represented a voluntary remission. The Assistant Commissioner agreed with this decision. The Commissioner, however, in disagreement with the opinion expressed by both these officers, has expressed his willingness to make further enquiries in the matter holding that the balance due was not a friendly gift but an irrecoverable loan. He has also indicated certain points which he desires the Assistant Commissioner to determine in connection with this matter. The assessee does not seriously object to this course being adopted. We accordingly hold that so far as item (e) was concerned, the Income-tax Officer was obliged in law to allow the deduction, and had in arriving at his decision misapplied the principles which in law govern the matter. This, however, does not preclude the Commissioner from making further enquiry into the matter on the lines indicated by him.

Item No. (1) represents a debt of Rs. 9,250 which was due to the assessee from Dewan Chand Maya Ram of Kasur. The debtor was adjudicated an insolvent on the 13th December 1930, and was ordered to obtain his discharge within two years. In fact he obtained a conditional discharge on the 26th April 1933. Unfortunately neither the assessee made a correct statement before the Income-tax authorities nor did the Assistant Commissioner properly appreciate the distinction between 'adjudication' and 'dis-

charge.' The Income-tax Officer had in the assessment year remarked that the debtor had been adjudged insolvent on the 13th December, 1930, and was discharged "after a year or so." He consequently came to the conclusion that the assessee could have written off this item then and as he did not do so he was not entitled to claim this deduction in the accounting year. Referring to this part of the Income-tax Officer's order the Assistant Commissioner observed as follows:

"The facts, as stated in the assessment order are not in dispute. * * * This certificate clearly shows that the debtor Dewan Chand was discharged on the 13th December, 1930. The assessee attaches undue importance to the fact that Dewan Chand had been called upon to render accounts of his income quarterly. This does not, however, change the fact that the discharge was granted to him in December, 1930, and that the amount became bad at that time. It should have been claimed as a bad debt in that year."

It would be obvious that this proceeds on entire misconception of facts. If the facts as stated in the assessment order were not disputed before the Assistant Commissioner, they nowhere stated that the debtor had been discharged on the 13th December, 1930, as misread by the Assistant Commissioner. Further, the condition referred to in the Assistant Commissioner's order was imposed upon the debtor at the time when he was granted a conditional discharge, *i.e.*, on the 26th April, 1933, and this being so, this condition could not have been in existence on the 13th December, 1930, as wrongly assumed by the Assistant Commissioner. Both the Income-tax Officer and the Assistant Commissioner have stressed the point that the assessee could claim this deduction long before the accounting year, but both have adduced reasons which are undoubtedly wrong. In these circumstances, their finding of fact is vitiated and cannot therefore be maintained. But as under the Privy Council judgment reported in *Commissioner of Income-tax, C.P.* v. *Sir S. M. Chitnavis* the Income-tax Officer is the sole arbiter to determine when a debt became bad we are not in a position to give our own finding in this matter. We accordingly remit this portion of the case back to the Commissioner with direction that fresh finding on the issue may be arrived at on correct materials. In this view of the case it will not be necessary to answer the question relating to this item.

Item No. (m) relates to a sum of Rs. 7,161-1-3 being a bad debt in the account of Dhanna Ram-Machhi Ram. Here, too the

debtor was adjudicated an insolvent and trustees were appointed to administer his estate in the interest of his creditors. On the 16th December, 1931, they issued a final distribution list on the basis of which the assessee is alleged to have received a sum of Rs. 329-9-0 on the 30th July, 1932, *i.e.*, during the accounting year. He was, however, called upon by the Income-tax Officer to explain why payment had been delayed in his case and he failed to produce either the trustees or any other reliable evidence which could throw light on this matter. As laid down in *Binjraj Hukam Chand* v. *Commissioner of Income-tax, Bengal*, where an assessee claims a deduction on account of the irrecoverability of a certain loan the onus lies upon him to prove that the loan had become bad in the year of account. As stated above, there is not a shred of evidence on the record in this respect and the Income-tax Officer was accordingly justified in holding that the assessee had failed to prove that he was entitled to claim this deduction in the accounting year. We accordingly answer the question relating to this item against the assessee, in other words, our answer would be that the Income-tax Officer was justified in disallowing the deduction and that he did not depart from or misapply the principles which govern the matter.

There will be no order as to costs.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

HAJI GHULAM RASUL-KHUDA BAKSH

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

TEKCHAND and ABDUL RASHID, JJ.

July 1, 1937.

FIRM—APPLICATION FOR REGISTRATION—POWER OF INCOME-TAX AUTHORITIES TO ENQUIRE WHETHER PARTNERSHIP IS REAL OR BOGUS—ONUS OF PROOF OF GENUINENESS—INDIAN INCOME-TAX ACT (XI OF 1922), SECS. 2 (14), 26-A—INCOME TAX RULES, RR. 1, 2.

An Income Tax Officer is not bound to register a firm under Sec. 26-A of the Indian Income Tax Act merely because the applicants have produced an instrument of partnership specifying the

individual shares of the alleged partners. It is open to the income tax authoritees to go into evidence, both direct and circumstantial, to determine whether the instrument of partnership is a genuine document or whether it merely embodies a bogus transaction got up for the purpose of evading income tax, and to refuse registration if they find that the instrument does not embody a genuine transaction. Further, the onus is on the person who applies for registration, to prove that a genuine instrument of partnership has been executed and that all persons named therein are real partners and not ' dummies '.

Cases referred to:

ABOWATH BROS. *v.* COMMISSIONER OF INCOME TAX, BURMA [1934] (7 I.T.C. 38).

DICKENSON *v.* GROSS [1927] (11 Tax Cas. 614; 137 L.T. 351).

RAGHU KARSON *v.* COMMISSIONER OF INCOME TAX, BIHAR & ORISSA [1931] (5 I.T.C. 389).

Application under Sec. 66 (3) of the Indian Income Tax Act, praying that the Commissioner of Income Tax, Punjab, may be required to state the case to the High Court: [Civil Miscellaneous No. 214 of 1937].

Kirpa Ram Bajaj, for the appellant.

Jagannath Aggarwal, for the Commissioner.

JUDGMENT.

ABDUL RASHID, J.—This is an application under Sec. 66 (3) of the Indian Income Tax Act, praying that the Commissioner of Income Tax may be required to state the case of the assessee, " Firm Haji Ghulam Rasul, Khuda Bakhsh " to this Court for the decision of the questions of law arising therein.

The firm Haji Ghulam Rasul Khuda Bakhsh consisted, according to the case for the assessee, of two partners, namely, the brothers Haji Ghulam Rasul and Haji Khuda Bakhsh, till the 1st July 1932. Haji Ghulam Rasul had a 12/16th and Haji Khuda Bakhsh 4/16th share in the firm. On the 1st July 1932, the constitution of the firm was changed and the three sons of Haji Ghulam Rasul, namely, Abdul Wahid, Abdul Rahman and Abdul Ghaffar, became partners in the firm to the extent of 3-16th, 3-16th and 2-16th respectively. The share of Haji Ghulam Rasul was reduced from 12-16 to 4-16th.

On the 21st March 1934, a partnership deed was executed evidencing the fact that the firm consisted of five partners, and that their shares were as specified above. On the strength of this deed of partnership an application was presented to the Income Tax authorities, under Sec. 26-A of the Indian Income Tax Act, for the registration of the firm. The Income Tax Officer was of the opinion that the deed of partnership was a bogus one, and that the three sons of Haji Ghulam Rasul were merely 'dummies' and not real partners in the firm. The Income Tax Officer gave a number of reasons for holding that the share of Haji Ghulam Rasul was 12/16 and that his sons were working in the firm as assistants of their father and not as real partners. On these findings the application for the registration of the firm was dismissed, and the firm was assessed to income-tax as originally constituted. Against this decision an appeal was preferred to the Assistant Commissioner of Income Tax. He affirmed the decision of the Income Tax Officer, and gave additional reasons for holding that the deed of partnership did not embody a genuine transaction. The Income Tax Commissioner was approached under Sec. 66 (2) of the Indian Income Tax Act to refer the case of the assessee to this court. On his refusal to do so an application was preferred to this Court under Sec. 66 (3) as already mentioned.

It was contended on behalf of the assessee that the provisions of Sec. 2 (14) and 26-A of the Indian Income Tax Act coupled with rules 2 to 4 framed under the Act left no option to the Income Tax authorities to refuse registration once an instrument of partnership specifying the individual shares of the partners was presented to them by the assessee. It was urged that the certificate produced by the assessee as regards the shares of the different partners must be regarded as conclusive of the matter by the Income Tax authorities, and that the manner in which they could prevent evasion of taxation was to resort to the provisions of Sec. 48 of the Income Tax Act and disallow refunds in the case of persons who were not proved to be genuine partners of the firm in question.

In my opinion the contention put forward on behalf of the assessee is devoid of all force. The instrument of partnership specifying the individual shares of partners referred to in Sec. 26 A of the Income Tax Act means obviously a genuine instrument of partnership. If there is evidence, direct or substantial, showing the bogus nature of the so-called instrument of partnership, it is open to the Income Tax authorities to refuse registra-

tion of the firm in question. Reference may be made in this connection to the case of *Dickenson* v. *Gross* (11 Tax Cas. 614). In that case a farmer had entered into a deed of partnership with his three sons with the admitted intention of reducing the income-tax liability in respect of the profits. There were, however, circumstances showing that the deed of partnership did not embody a genuine transaction between the father and the sons. In these circumstances it was held that as a partnership did not exist in fact, there was no partnership for the special purpose of the Income Tax Act.

In a case reported as *Abowath Bros.* v. *Commissioner of Income Tax, Burma,* where a deed was drawn up as a partnership deed between the assessee and his major son for avoiding income tax, the two minor sons not being admitted to the benefits of partnership, but no capital account was opened or any capital shown as the son's contribution, it was held that there was material on which the Income Tax Officer could find as a fact that a partnership did not exist. This case was not a case of a Hindu undivided family and was not governed by Sec. 25-A of the Act.

Reference may also be made to a Bombay case reported as *Sookinabhoy Salebhoy* v. *Commissioner of Income Tax, Bombay.* In that case the assessee was a Muhammadan lady, and a document was put forward for registration as an instrument of partnership between the lady and her three minor children. This document purported to show the shares of the different partners in the profits of the firm without stating the business of the firm, or its assets, or wherefrom the profits were derivable and there was no combination of property, labour or skill other than the income proposed to be shared with her children which the lady received from certain investments in shares of a large sum of money left by her father. Registration was refused by the Income Tax authorities on the ground that the whole transaction was illusory and bogus and that the deed of partnership was executed for the purpose of evading income tax only. It was held by the High Court that the circumstances showed that in point of fact there was no partnership as defined in Sec. 239 of the Indian Contract Act.

The principle underlying all the rulings mentioned above is that it is open to the income tax authorities to go into evidence both circumstantial and direct, to determine whether the instrument of partnership is a genuine document or whether it merely embodies a bogus transaction for the purpose of evading the tax

These rulings are fully applicable to the facts of the present case. It appears to me, therefore, that the Income Tax Officer was fully entitled to refuse registration of the firm if as a fact he found that the instrument of partnership did not embody a genuine transaction.

The next point urged by the learned counsel for the assessee is that the onus of showing that the three sons of Haji Ghulam Rasul were not partners in the firm was on the Department and that this onus had not been discharged. On this point also I do not agree with the contention put forward on behalf of the assessee. It was for the assessee, who applied for registration, to prove that a partnership in fact existed and who were the partners. In a case reported as *Raghu Karson* v. *Commissioner of Income Tax, Bihar & Orissa*, it was claimed on behalf of the assessee that he was carrying on business in partnership, the partners being members of his family entitled to and paid a share in the profits. The Income Tax Officer was not satisfied with the evidence called in support of the contention by the assessee and assessed him as an individual on the profits of the business. It was held that the assessee having failed to discharge the onus of establishing that the business managed and controlled by him was a partnership, he was rightly assessed as an individual on the profits of the business. The onus would thus rest on the person, who applies for the registration of the firm, to prove that a genuine instrument of partnership has been executed and that all the persons named therein are actual persons and not "dummies".

In the present case it was alleged by the assessee that the three sons of Ghulam Rasul had become partners on the 1st July 1932. No deed of partnership was, however, executed till the 21st March 1934. No application for the registration of the firm was made till the 20th March 1934. On the conclusion of the financial year 1932-33 the profits were not divided between the different partners. A division of profits took place on the 31st March 1934, and a sum of Rs. 12,776 is alleged to have fallen to the shares of the three sons of Ghulam Rasul. They are alleged to have withdrawn their entire profits on the same day. No evidence, has, however, been tendered to show what became of the profits in the hands of Abdul Wahid, Abdul Rahman and Abdul Ghaffar. The three sons of Ghulam Rasul live in the houses belonging to their father and all their household expenses continue to be paid by Ghulam Rasul. There is no proof that any of the sons of Ghulam Rasul contributed anything

towards the capital of the firm nor has it been established that they possess any separate property from which the losses, if any, could have been recovered.

The above mentioned circumstances, in my opinion, provide ample material for the finding that the firm really consists of Haji Ghulam Rasul and Haji Khuda Bakhsh only and that the three sons of Haji Ghulam Rasul are not partners in the firm but are merely assisting their father in running the business. In this view of the matter no question of law arises in the present case. I would, therefore, dismiss this application. The parties will bear their own costs of these proceedings.

TEKCHAND, J.—I agree.

Application dismissed.

[IN THE LAHORE HIGH COURT.]

ANANT RAM KHEM CHAND *v.* COMMISSIONER OF INCOME TAX, PUNJAB.

TEK CHAND and ABDUL RASHID, JJ.

June 15, 1937.

PATENT—TRANSFER OF PATENT RIGHTS IN CONSIDERATION OF ANNUAL PAYMENTS TO TRANSFEROR—ANNUAL PAYMENTS, WHETHER INCOME OR CAPITAL RECEIPT—ASSESSABILITY—DIFFERENCE BETWEEN OUTRIGHT SALE OF PATENT AND GRANT OF WORKING LICENCE—CASUAL AND NON-RECURRING RECEIPT—INDIAN INCOME TAX ACT (XI of 1922), Sec. (3) (*vii*).

The assessee was the patentee of a tube well boring strainer called the 'Khem Patent'. In April 1933 he conveyed his patent rights to one Diwan Chand for the remaining term of the patent in consideration of the latter agreeing to pay him 10 per cent of the net price realised on the sales. In March 1934 a tripartite agreement was entered into between the assessee, Diwan Chand, and a limited company (which was the owner of a rival patent called the Tej Patent) under which the prior agreement between the assessee and Diwan Chand was cancelled and the assessee granted 'unto the company full licence and authority to make, manufacture or cause to be manufactured, use, vend etc.' strainers according to the specification of the Khem Patent 'during the unexpired term of the Tej Patent and any prolonged or extended period thereof' and the

company agreed to pay the assessee in consideration of the conveyance of the patent Rs. 4,500 per annum for the term set forth in the deed. In accordance with this agreement the assessee received Rs. 4,500 during the accounting year 1934-35. Held, on a construction of the agreement in question, that the transaction was not a sale of the patent rights for an ascertained sum payable in instalments but only the grant of a working licence for a number of years on certain conditions, the property in the patent remaining in the grantor, and the annual payment received by the assessee was therefore 'income' and was not exempt from assessment to income-tax under Sec. 4 (3) (vii) *of the Indian Income Tax Act.*

In cases of this nature if the transaction is an out and out sale of the patent by the patentee for a definite price, even though the price is not payable in lump sum but in instalments, the instalments received would not be 'income' but capital receipts. But if it is merely a working licence granted for an annual payment it would be 'income' and as such taxable.

Cases referred to :—

COLLINS *v.* FIRTH-BREARLEY STAINLESS STEEL SYNDICATE LTD. [1925] (9 Tax. Cas. 520).

CONSTANTINESCO *v.* REX [1926] (11 Tax Cas. 730 ; 42 T.L.R. 383 ; 43 T.L.R. 727).

CALIFORNIAN COPPER SYNDICATE *v.* HARRIS [1904] (5 Tax Cas. 159 : 6 F. 894).

HUDSON'S BAY CO., LTD. *v.* STEVENS [1909] (5 Tax. Cas. 424 ; 42 T.L.R. 685 ; 101 L.T. 96 ; 25 T.L.R. 709).

JONES *v.* COMMISSIONERS OF INLAND REVENUE [1930] (7 Tax Cas. 310 ; 1920, 1 K.B. 711 ; 89 L.J.K.B. 129 ; 121 L.T. 611).

SCOBLE *v.* SECRETARY OF STATE FOR INDIA [1903] (1903 1 K.B. 494 ; 72 L.J.K.B. 215 ; on appeal 72 L.J.K.B. 617 ; 1903 A.C. 299 ; 4 Tax Cas. 618).

TEBEAU (JOHORE) RUBBER SYNDICATE LTD. *v.* FARMER [1910] 5 Tax Cas. 658; 1910 Sess. Cas 906 ; 47 Sc. L.R. 816).

Case stated by the Commissioner of Income Tax, Punjab, N.W.F. and Delhi Provinces under Sec.66 (2) of the Indian Income Tax Act (XI of 1922) in the matter of the assessment of Messrs. Anantram Khemchand for the assessment year 1935-36. [Civil Ref. No. 11 of 1937).

Kirparam Bajaj for assessees.

J. N. Aggarwal and *S. M. Sikri* for the Commissioner of Income Tax.

The facts and all the material clauses of the agreement are referred to in detail in the judgment of *Tek Chand, J.*

JUDGMENT.

TEKCHAND, J.—This is a reference by the Income-tax Commissioner, Punjab and North West Frontier Province, under Section 66 (2) of the Income-tax Act referring to this Court a question of law arising from the petitioner's appeal against the assessment for 1935-36, made on his income for the "accounting period", 1934 35. The assessee is an undivided Hindu family known as Anant Ram-Khem Chand, which for brevity's sake will be described hereinafter as "Khem Chand".

The facts, as disclosed in the "Stated Case" and its annexures, as admitted by both the counsel before us, are that Khem Chand was the patentee of a tube-well boring strainer, known as the "Khem Patent". The letters patent relating to this strainer were granted to Khem Chand by the Governor General on the 20th of November 1929 but were to have effect from the 10th of August 1927 for a period of 16 years, *i.e.*, till the 9th of August 1943. Khem Chand manufactured strainers of this patent, and used and sold them till the 20th of April 1933, when he conveyed the patent rights to one Pandit Diwan Chand of Lahore for the remaining term of the patent, in consideration of Diwan Chand agreeing to pay him 10 *per cent.* of the net price realized on the actual sales. The arrangement continued till the 5th of March 1934, when it was cancelled by mutual consent. On that date, a tripartite agreement was entered into between the original patentee (Khem Chand) the first transferee (Diwan Chand) and a private limited Company known as Reliable Water Supply Service of India Limited, Lahore, (which for brevity's sake will be called hereinafter "the Company"). This Company had itself taken out a patent for another tube well boring strainer, known as the "Tej Patent", for a period of 16 years, commencing the 12th of May 1925, and had been manufacturing and selling these strainers on a large scale. In order to avoid competition by the strainers of the "Khem Patent", the Company came to an arrangement with Khem Chand his transferee Diwan Chand; and all three executed the agreement above referred to on the 5th of March 1935, which is printed *verbatim* at pages 6 to 12 of the paper-book. By this agreement; the earlier agreement between Khem Chand and Diwan Chand, dated the 20th of April 1933, was cancelled, and Khem Chand granted "unto the Company full licence and authority to make, manufacture or cause to be manufactured,

use, exercise and vend—strainers for tube-wells under and according to the specification of the Khem Patent during *the term now unexpired of the Tej Patent and any prolonged* or extended period thereof ". In consideration of Diwan Chand cancelling his agreement, the Company agreed to pay to him (Diwan Chand) Rs. 4,000 a year; and in consideration of the conveyance of the patent by Khem Chand to the Company it agreed to pay him Rs. 4,500 *per annum* " on the conditions and covenants and for the term set forth in the document ". Such of these conditions as are material for the disposal of this case will be mentioned later.

In accordance with the terms of this agreement, the Company paid the first instalment of Rs. 4,500 to Khem Chand during the " accounting period ", 1934-35. In the course of the assessment for the year 1935-36, which was to be made on his income for 1934-35, Khem Chand claimed before the Income Tax Officer that this sum was exempt from assessment. He contended that it was not " income " within the meaning of Section 4 (3) of the Income Tax Act, but it was a " capital receipt ", being a part of the sale price of the patent, which instead of having been paid in one lump sum, had been made payable in annual instalments of Rs. 4,500 till the expiry of the patent. The Income Tax Officer overruled this contention, and included this item in the assessable income of Khem Chand. It appears from his order that he treated the transaction between Khem Chand and the Company as one of sale of his patent rights, but he held that as these rights had not been sold " for a lump sum consideration ", but " on the other hand the assessee is to get it (payment) regularly every year " for a number of years, it was " in the nature of a fixed royalty " and, therefore, liable to assessment.

On appeal, the Assistant Commissioner held that the payment being ' in the form of money received for the use of a capital asset, as for instance, rent realized for the use of house property, and these receipts being of recurring nature, paid every year for benefit derived from the patent ", it was taxable profit. He accordingly dismissed the appeal.

The assessee applied to the Commissioner under Section 66 (2) for making a reference to the Court to decide the question of law involved, and contended that the Income Tax Officer and the Assistant Commissioner had mis-understood the real nature of the transaction which was one of " sale of a capital asset, and the annual receipts were instalments of the sale price ". The Com-

missioner has made this reference, but has expressed his opinion against the assessee's contention. He has observed that on a proper reading of the conveyance, the transaction was not one of "sale", but was rightly described as a "licence", on which royalty is payable annually to the assessee. He has also expressed the opinion that even if the "conveyance be not regarded as a continuing licence but an outright transfer of rights once and for all, still the receipts lay properly in revenue account, being profits and gains therefrom which arose in the course of the assessee's business". With this expression of opinion, the learned Commissioner has formulated the following question of law for determination by this Court:

"The assessee having owned patent rights which were originally used in his business: having conveyed the working rights under licence against payment of profit-shares; and having converted his rights under that conveyance into licence under the annexed agreement against an annual payment; query: are the annual receipts under the said agreement such that in principle and law it was impossible for the Assistant Commissioner to find that they were 'income, profits or gains', and were not established to be exempted by Sec. 4 (3) (vii) of the Act?"

The answer to this question depends on the determination of the nature of the transaction as disclosed in the agreement of the 5th of March 1934. If the transaction was an out-and-out sale of the patent by Khem Chand to the Company for a definite fixed price, even though it was not payable in lump sum but in instalments, there can be no doubt that any such instalment received during the accounting period cannot be treated as taxable "income", but is a "capital receipt" and as such exempt from assessment. If, on the other hand, it was merely a "working licence" granted for an annual payment, it is clearly "income" and as such is taxable. I may remark here, that the Income Tax Officer was clearly in error in his law, (*sic*) while treating the transaction as one of sale, considered that the amount received would be exempt only if the patent rights had been sold "for a lump sum consideration". This matter was decided long ago in the celebrated case of *Scoble v. The Secretary of State in Council for India* (1903, 1 K.B. 494), which is regarded as the leading authority on the subject and has since been followed in numerous cases in England as well as in India. Similarly, I think, the learned Commissioner was not right in laying too much emphasis on the circumstances that the assessee had originally used the patent

rights in question in his own business of manufacture and sale of the strainer, or that, in 1933 he had conveyed the working rights under the licence to Diwan Chand against payment of a share in the profits. It is not alleged that the assessee has been carrying on the business of *acquiring and selling of patents as a regular trade.* If that were so, there can be no doubt that the price received by him by the sale of any particular patent would be income within the meaning of the Act and assessable as such. In that event, the case would be similar to that of a speculator in immovable properties, who purchases and sells such properties as a regular trade. The profit made by him in any transaction would clearly be his taxable income. But this would not be so if a person who had inherited immovable property or had acquired it as an investment, subsequently sold it at a profit [see *Californian Copper Syndicate (Limited and Reduced)* v. *Harris* (5 Tax Cases 159), the *Hudson's Bay Company Limited* v. *Stevens* (5 Tax Cases 424) and *Tebeau (Johore) Rubber Syndicate Limited* v. *Farmer* (5 Tax Cases 658)]. The fact therefore, that Khem Chand himself had manufactured and sold strainers of this patent from 1927 to 1933 is immaterial for the decision of the point before us. Similarly, the terms of his transactions with Diwan Chand can have no bearing on it. That transaction was, as pointed out by the learned Commissioner himself, a working licence for a number of years in which no fixed sum was to be paid to Khem Chand, but he was to receive a royalty on a percentage basis on the net profits made by the grantee. The amount of the royalty so received would clearly be assessable in the hands of the grantors : *Jones* v. *Commissioners of Inland Revenue* (7 Tax Cases 310).

For ascertaining the real nature of the transaction between Khem Chand and the Company, we must look to the agreement of the 5th of March 1934. In this document, the transaction is described as a 'licence' and the amount payable annually by the Company to the grantor is stated to be 'royalty'. But, as rightly pointed out by the learned Commissioner himself, too much stress cannot be laid on the use of these words. We must look to the substance of the transaction, as is disclosed in the agreement, read as a whole. If we find, as is contended by the assessee's learned counsel, that it was an out and out sale for an ascertained sum, the payment of which was spread over a number of years, we must hold that by this transaction his capital asset was transmuted from the form of a patent to a sum of money payable in fixed instalments. If, however, we come to the conclusion that it was

nothing more than the grant of a working licence for a number of years on certain conditions, the property in the patent not being transferred absolutely to the grantee but still remaining in the grantor, the verdict must be against him.

Now a perusal of paragraphs 3, 4, 6, 7, 9 and 16 of the agreement clearly shows that the assessee, Khem Chand, had not transferred completely the ownership of the patent to the Company, nor can it be said that the price payable was a fixed, definite amount, payment of which had been spread over a number of years. Paragraph 3 provides that the sum of Rs. 4,500 was payable annually by the grantee to the grantor during the subsistence of the agreement. In paragraph 6 it is stated that "the date of expiry of the agreement shall be the date on which either of the two patents (Tej Patent and Khem Patent) first expires, otherwise than for non-payment of renewal fees. *Extension granted to either or both shall be considered as keeping alive the patent or patents so extended.*" As already stated, the Tej Patent was taken out on the 12th of May 1925, and the Khem Patent on the 10th August 1927. Under Sec. 14 of the Patents and Designs Act, II of 1911, therefore they are to expire on the 11th of May 1941 and 9th of August 1943 respectively. Consequently, under the first part of paragraph 6, the agreement between Khem Chand and the Company would expire in May 1941; but the second part keeps it alive for such further period for which an extension might be granted to either or both of the parties. Under Sec. 15 of the Act, the term of 16 years may be extended by the Governor-General or the High Court, to a period not exceeding 5 years which in exceptional cases might be enlarged to 10 years. It is thus clear that the agreement would not necessarily determine in 1941; it might be kept alive for a further unknown period which may expire at any time between 1942 to 1953, during which time the Company would be liable to pay to the assessee Rs. 4,500 *per annum.* Obviously, it cannot be said that the transfer was for an ascertained, fixed and definite sum.

Further, in paragraph 16 of the agreement it is provided that "notwithstanding that the licence hereby granted ceases on the expiry of the Tej Patent, the Company shall nevertheless by giving three months' previous notice in writing to Khem Chand have the option to continue the manufacture, vend and use of the strainer as heretofore on payment of the royalty and of the sum at the rates hereinbefore mentioned."

Again, paragraph 7 lays down that if at any time during the

currency of the agreement, the Company goes into liquidation, the licence shall stand determined and on such determination Khem Chand shall have the right to use and vend the strainers of this patent. All these conditions make both the duration of the "licence," and the total amount payable still more uncertain.

Nor can it be said that the grantor had parted with the *corpus* of the patent. The property in it still remains in him, and in paragraph 9 it is provided that if any improvements are made in respect of these strainers during the currency of the agreement, such improvements shall belong to Khem Chand, who alone will have the exclusive right of having them patented, though, of course, the Company will have the right to use and vend the improved strainer during the subsistence of the licence without payment of any additional royalty. For the assessee, it was urged that these and other similar provisions were entered for the protection of the rights of an unpaid vendor. But after consideration, I do not think that this is so. It seems that what was transferred to the Company was not the *corpus* but the *usufruct* of the patent for an uncertain period in consideration of an amount, which had not been, nor could be, definitely known.

The learned counsel for the assessee laid much stress on paragraph 15 of the agreement, which is to the effect that the company shall "be entitled to assign, grant, license, sell, dispose of or in any manner deal with the rights hereby assigned to it." This, however, is not conclusive of the matter. It merely gives the Company right to grant a sub-licence of the working rights in the patent during the subsistence of the licence, and provides that the sub-licence shall be subject to the same conditions and limitations under which the licence had been granted to the Company. Nor can he derive any support from paragraphs 12 and 14, according to which the Company was to pay all renewal fees and cost of extension applications, and was empowered to bring suits against third parties for any infringement, or threatened infringement of the patent.

Both counsel cited a number of rulings before us, but I do not think it necessary to discuss them in detail, as the governing principles are well settled and the decision in each case turned on its own peculiar facts. For the assessee reliance was placed principally upon *Collins* v. *The Firth Brearley Stainless Steel Syndicate, Limited* (9 Tax Cases 520). In that case certain patents were assigned for a capital sum of £25,000 payable in ten equal instalments and in addition, a royalty was payable "so long as the

patent may survive, be it 16 years or be it a longer period." It was held that the annual instalments of £2,500, in which the capital sum was to be paid, were not taxable, but that the royalty of £1,000 payable during the subsistence of the patent *was* liable to assessment. This decision, in my opinion, is clearly against the contention of the assessee in this case. Here, as already stated, the assignment was not for a capital sum, but was for Rs. 4,500 payable annually so long as the Khem or the Tej Patent may survive. It is, therefore, clearly like the royalty payable in the case cited and is assessable. In this connection, reference may also be made to the decision of the House of Lords in *Constantinesco* v. *Rex* (11 Tax Cases 730 at 746) where it was held that if what was assigned was merely the use of the invention for a period of time, and the *corpus* of the patent was not taken away from the grantor but still remained his property, it was "income" and as such assessable.

In this view of the case, no question of exemption under Sec. 4 (3) (vii) arises, as the receipt cannot possibly be said to be "casual" or "non-recurring."

For the foregoing reasons, I would answer the question referred to us against the assessee, holding that the annual receipt of Rs. 4,500 under the agreement is "income, profits and gains," and that it is not exempt from assessment under Sec. 4 (3) (vii). I think, however, that this is a fit case in which the parties should be left to bear their own costs in this court.

ABDUL RASHID, J.—I agree.

Question answered accordingly.

[IN THE JUDICIAL COMMISSIONER'S COURT OF SIND.]

GOKALDAS LAKHMICHAND

v.

COMMISSIONER OF INCOME TAX, BOMBAY.

RUPCHAND BILARAM and D. C. MEHTA, A.J.Cs.

January 14, 1937.

LOSS—RIGHT TO SET OFF—LOSS IN BUSINESS—TRANSFER OF BUSINESS OR WITHDRAWAL FROM FIRM BEFORE ASSESSMENT —RIGHT TO SET OFF LOSS AGAINST OTHER INCOME—SCOPE OF SEC. 26 (2)—INCOME TAX ACT (XI OF 1922), SECS. 24, 26 (2).

Where an assessee sustains a loss in any year in a business in which he is a partner, or of which he is the sole owner, he is entitled to set off this loss against his income of that year under the other heads mentioned in Sec. 6, even though before the time of assessment arrives he withdraws from the firm or transfers his business to another. There is nothing in Sec. 26 (2) which precludes him from doing so.

During the accounting period November 1929 to October 1930 the assessee received an income of Rs. 4,971 under the head property. A firm in which he had a half-share incurred a loss of Rs. 41,916 in that year and in another business of which the assessee was the sole owner he incurred a loss of Rs. 1,700. In August 1930 he withdrew from the partnership and sold his sole business also to his partner. The income tax authorities held that he was not entitled, in view of Sec. 26 (2) of the Act, to have these losses set off against his income as he had, before the time of assessment, withdrawn from the firm and transferred his business to another. Held, *that under Sec. 24 the assessee was entitled to have the losses set off against his income even though he had ceased to be a partner of the firm and had transferred his business before the date of assessment.*

Application under Sec. 66 (2) of the Indian Income Tax Act. Civil Revision Application No. 136 of 1933.

Fatechand Assudomal for the Assessee.
Charles M. Lobo for the Commissioner.

JUDGMENT.

RUPCHAND BILARAM, A. J. C.—The facts giving rise to this application are briefly as follows: The petitioner Gokaldas Lakmichand was required to fill in his form under the Income-tax Act showing what was the net income received by him during the accounting period November 1929 to October 1930 for the purpose of being assessed thereon for the year 1st April 1930 to 31st March 1931. During the period he had received an income of Rs. 4,971 from immoveable property possessed by him, and had suffered a heavy loss in the business carried on by him. He was a partner with one Kishinchand Ramchand in a certain business and in that business the partnership suffered a loss of Rs. 41,916 and his share therein was half. He was also the sole proprietor of a felt factory in which he had a loss of Rs. 1,700 odd. He accordingly showed in his form that he had suffered a loss of Rs. 22,337 and claimed exemption from income-tax. Now, i

appears that in August 1930 Gokaldas and Kishinchand came to a settlement and in accordance therewith the business which was formerly carried on by Gokaldas and Kishinchand in partnership as also the felt factory were taken over by Kishinchand. The question how Gokaldas and Kishinchand should be assessed did not come up for consideration before the Income-tax Officer until August 1932. The delay was due to several reasons, the principal reason being that certain information had been called for from the Punjab where a part of the business was carried on and was received late.

The Income-tax Officer refused to allow credit to Gokaldas for the loss of Rupees 22,337 and taxed him on an income of Rs. 4,971. His appeals to the Assistant Commissioner of Income-tax and to the Commissioner of Income-tax have failed. The ground on which the Income-tax authorities have proceeded to tax Gokaldas on the income from rents is that as the business formerly carried on by him in partnership with Kishinchand and the felt factory business carried on by him on his own account were both transferred to Kishinchand in August 1930 and belonged to Kishinchand at the time when the assessment was being fixed, S. 26 Cl. (2) of the Act applied and therefore Gokaldas could not claim the benefit of the loss suffered by his firm in which he was a partner or by the felt factory of which he was the sole proprietor. An application by Gokaldas to the Commissioner of Income-tax asking him to refer the legal points arising out of his order to this Court was refused resulting in an application being made to this Court under S. 66, Cl. 3 of the Income-tax Act. But before that application was heard the Commissioner of Income-tax offered to refer the case to the Court and he was accordingly ordered to do so. In the case stated by him he has propounded the question of law for our decision in these words:

"If the petitioner was not a partner in the Karachi firm of Messrs. Lakhmichand Meghraj (subsequently styled as Messrs. Lakhmichand Ramchand) and in the Mohatta Felt Factory at the time of the assessments of these two concerns for the financial year 1931-32, can he claim any share of the loss incurred by these two concerns during 1930-31 or Sambat 1986 to be set off against his personal income earned in 1930-31 or Sambat 1986 for the purposes of his 1931-32 assessment?"

We are afraid the above question does not accurately bring out the point of law arising out of the case. The petitioner was indubitably the assessee; he had been asked to submit his form

under the provisions of S. 22 read with S. 6, Income-tax Act, showing his income under the following heads: (*i*) salaries; (*ii*) interest on securities; (*iii*) property; (*iv*) business; (*v*) professional earnings; and (*vi*) other sources. He had derived an income from property but had suffered a loss in business. Accordingly he showed his income from property and claimed a set-off against his loss in business.

Now S. 24 (1) of the Act reads as follows:

"Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in S. 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year."

The applicant is the assessee. He had suffered a loss in one of the heads mentioned in Sec. 6. Indubitably therefore he was entitled to have the amount of the loss which he had sustained in that year under the head of business set off against the income which he had derived from his properties. Sec. 24 does not say that if the assessee is a member of a firm, he must in order to claim the benefit of that section show that his firm had been assessed in the year in issue before he can claim the benefit of the loss. As a matter of fact if a firm has suffered a loss in any particular year there would be no assessment against that firm in that year. It is therefore not possible for us to hold that there was any obligation upon the petitioner to show that the firm in which he was a partner and had suffered the loss was in existence or that it had not changed hands and was assessed. The learned Commissioner has relied upon Sec. 26 Cl. (2) of the Act in refusing to recognize the claim of the petitioner. That clause deals with change of ownership of business and is as follows:

"Where, at the time of making an assessment under Sec. 23 it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year."

It is again difficult for us to hold that these provisions apply to the assessment to be levied on Gokaldas, whatever might be said with regard to their applicability to the assessment to be levied on Kishinchand. If instead of there being a loss there had been a profit in the business taken over by Kishinchand, Kishinchand as the successor of the business might have been taxed on the foot-

ing of such profit; but this sub-section does not go further and say that if as a matter of fact there has been a loss resulting in one of the partners withdrawing from the firm, such partner is not entitled to set off his share of the loss against the profit, so far as his own assessment is concerned. We accordingly hold that in the circumstances of this case Gokaldas was entitled to set off the loss which he had suffered during the accounting period in the business carried on by him in partnership with Kishinchand and also in the business carried on by him as sole proprietor of the felt factory against the income which he had derived from his properties and that the fact that both these concerns were taken over by Kishinchand subsequent to the accounting period but before the date on which the order of assessment was passed, did not prevent Gokaldas from claiming to set off the loss suffered by him in business against his income from other sources. We answer the reference accordingly.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

PARAS DASS MUNNA LAL v. COMMISSIONER OF INCOME TAX, PUNJAB.

TEKCHAND AND ABDUL RASHID, JJ.

June 16, 1937.

ACCOUNTING—OMISSION TO INCLUDE IMPORTANT ITEMS—REJECTION OF ACCOUNTS—ASSESSMENT OF SALES AT AVERAGE FOR LAST TEN YEARS AND APPLYING FLAT RATE—LEGALITY OF ASSESSMENT—'EVIDENCE' MEANING OF—INDIAN INCOME TAX ACT (XI of 1922), Sec. 23 (3).

The assessee, a cap merchant made a return for the accounting year 1934-35 showing a profit of Rs. 3,638 from business. The Income-tax Officer found that the assessee had purchased a house for Rs. 50,000 a few years back and had been realising a rent of Rs. 2,320 per year, he had spent Rs. 50,000 for defending his son in a criminal case, and that the assessee had purchased property worth Rs. 18,000 in 1933 and property worth Rs. 21,000 in 1934. None of these transactions were shown in the accounts. The accounts were consequently rejected and the Income-tax Officer taking an average for the last ten years assessed the sales at Rs. 1,50,000 and calculated the profits at a flat rate of 15 per cent : Held, *that the*

omission of the various transactions mentioned above afforded material for rejection of the accounts, and there was also evidence justifying the fixing of the sales at Rs. 1,50,000 and applying a flat rate of 15 per cent for calculating the profits under Sec. 23 (3) of the Income Tax Act.

The word 'evidence' as used in sub-Sec. (2) of Sec. 23 of the Income Tax Act is not confined to direct evidence, but is comprehensive enough to cover circumstantial evidence.

COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA *v.* SIR KAMESWAR SINGH OF DARBHANGA [1937] (I.L.R. 12 Pat. 218; 60 I.A. 146; 6 I.T.C. 401; A.I.R. 1933 P.C. 108; 1933 I.T.R. 94) *followed.*

Application under Sec. 66 (3) of the Indian Income Tax Act praying that the Commissioner of Income Tax, Punjab and N.W.F.P., may be required to state the Case.

[Civil Miscellaneous No. 178 of 1937].

ORDER.

This is an application under Sec. 66 (3) of the Indian Income-tax Act praying that a mandamus be issued to the Commissioner of Income-tax, Punjab, North West Frontier and Delhi Provinces, requiring him to state the case of Messrs. Paras Dass Munna Lal, Cap Merchants, Delhi, and refer it to this Court for the determination of the question of law arising therein. The question of law has been formulated by the assessee in the following terms:—

"Whether there is any material on the record justifying the rejection of accounts and estimating the sales at Rs. 1,50,000 and applying a flat rate of 15 per cent profits to the sales."

The assessee, who is a cap manufacturer, carries on wholesale trade in that commodity in the City of Delhi. The sales as shown by his account books for the last ten years are as follows:

	Rs.
1925-26	2,70,336
1926-27	2,20,909
1927-28	2,12,340
1928-29	1,35,114
1929-30	2,24,784
1930-31	1,85,979
1931-32	1,54,785
1932-33	51,380
1933-34	49,380
1934-35	81,866

The books show a capital account of Rs. 1,20,000 which is increased or decreased by the profit or loss shown in each year. During the assessment for the year 1934-35 it came to the knowledge of the income-tax authorities that the assessee had purchased a house in Chandni Chowk seven years previously for a sum of Rs. 50,000 and that he had been realizing its rent amounting to Rs. 2,320 per year. Neither the purchase of the house nor the realisation of the rent was shown in any of the books of account produced by the assessee. The amount of rent was also not included in the return made by the assessee.

It also came to light that the adopted son of the assessee had been implicated in a conspiracy case some time in the year 1931 or 1932 and the assessee had spent a sum of about Rs. 50,000 in defending him. Property worth Rs. 18,000 had been purchased by the assessee in October 1933 and another house was purchased by him for a sum Rs. 21,000 in June 1934. None of the four transactions referred to above finds any place in the account books of the assessee.

The accounting period in this case is the 5th of July 1932, to the 24th of June 1933. The books of the assessee show that sales amounting to Rs. 81,866 had taken place during this period. In view of the omission from the books of the assessee of the transactions referred to above, the Income-tax Officer came to the conclusion that the books did not reveal the true extent of his business both as regards sales and as regards profits. In view of the large business that had been carried on by the assessee for the ten years from 1925-26 to 1934-35, the sales for the accounting period were fixed at the sum of Rs. 1,50,000. The Income-tax Officer calculated the profits at a flat rate of 15 per cent for wholesale business. The assessee was taxed on an income of Rs. 20,841 to tax and sur-tax aggregating Rs. 2,578-1 as against the declared income of Rs. 3,983-5-4 from property and Rs. 3,638-3-8 from business. The Assistant Commissioner of Income-tax rejected the appeal of the assessee and the Commissioner declined to make a reference to this Court under Sec. 66 (2) of the Income-tax Act.

The case of the assessee was that the sum of Rs. 50,000 for the purpose of purchasing a house in Chandni Chowk, Delhi, Rs. 50,000 for the expenses of the conspiracy case, and Rs. 39,000 for the purchase of property in the years 1933 and 1934 were not shown in his books, as these sums were taken from the reserves of money that he had at home. This explanation was found to be utterly unsatisfactory by the Income-tax authorities, and they,

accordingly, came to the conclusion that the accounts of the assessee did not reveal the true state of his business and that his income could not properly be deduced from those books. In the circumstances, I am of the opinion that the omission of these transactions from the account books of the assessee did provide some material justifying the rejection of the accounts. It is not open to the High Court to go into the question of the sufficiency of this material.

The next question for consideration is whether the estimate of Rs. 1,50,000 is based on any material. The main ground given by the Income-tax authorites for fixing the sales at Rs. 1,50,000 for the year under assessment is the fact that the assessee had been carrying on a very large business from 1926 to 1934. His sales in the year 1925-26 amounted to Rs. 2,73,336. The sales in the year 1931-32 amounted to Rs. 1,54,785. Thereafter there was a sudden drop. The sales in the next three years amounted to Rs. 51,380, Rs. 49,380 and Rs. 81,866 respectively. It appears that the figure of Rs. 1,50,000 was worked out by taking a rough average of the business of the assessee for the last ten years. Past assessments, therefore, provided the material for the fixing of the sales at Rs. 1,50,000.

Though the sales in the last three years, according to the books of the assessee, decreased considerably, there was no consequent decrease in the staff employed by the assessee or in the overhead charge. The shop expenditure in 1925-26 when the sales amounted to Rs. 2,70,336 was Rs. 5,365. In subsequent years the expenditure account throughout has been between Rs. 5,000 and 6,000.

The word 'evidence' as used in sub-Sec. (2) of Sec. 23 of the Income-tax Act obviously cannot be confined to direct evidence. This word is comprehensive enough to cover circumstantial evidence. The circumstances alluded to above, in my opinion, provide material for fixing the sales during the year under review at the sum of Rs. 1,50,000.

In the year 1933-34 the assessee himself showed that he had made a profit of 15 per cent on the sales. There was, therefore, material for the Income-tax Officer to come to the conclusion that a flat rate of 15 per cent was a reasonable rate of profit in this case. The rate of profit so far as retail trade in caps is concerned, according to the Income-tax Officer, is 25 per cent.

In a case reported as I.L.R. 12 Patna 318 an asssessment was made under Sec. 23 (3) of the Indian Income-tax Act. It was argued in the High Court in that case that the Income-tax Officer

was not entitled to make a guess without any evidence. The court agreed with the contention but held that the state of affairs in the previous years, coupled with the fact that the assessee had a large mortgage loan business and must have enforced mortgages by sale on many previous occasions afforded ample material for the assessment made. When the case went up to the Privy Council their Lordships agreed with the observations made in the judgment of the High Court and added that if the assessee wished to displace the Taxing Officer's estimate it was open to him to adduce evidence of all his purchase transactions during the year and of the financial results thereof which he apparently had made no attempt to do.

Following I.L.R. 12 Patna 318, I would hold that in the present case there was evidence justifying the rejection of the accounts and justifying the fixing of the sales at Rs. 1,50,000 and applying a flat rate of Rs. 15 per cent profits under Sec. 23 (3) of the Indian Income-tax Act. I would, therefore, dismiss this application but leave the parties to bear their own costs.

TEK CHAND, J.—I agree.

Application dismissed.

[IN THE SIND JUDICIAL COMMISSIONER'S COURT.]

COMMISSIONER OF INCOME TAX, BOMBAY

v.

K. H. KATRAK.

RUPCHAND BILARAM and D. C. MEHTA, A. J. Cs.

February 4, 1937.

AGENCY—TERMINATION OF AGENCY—ANNUITY PAID TO AGENT FOR SERVICES RENDERED AND TO AVOID COMPETITION—WHETHER ASSESSABLE—'SALARY' OR CASUAL AND NON-RECURRING RECEIPT—INDIAN INCOME TAX ACT (XI of 1922), Secs. 4(3),7.

Katrak & Co. of Karachi acted as agents at Karachi of B.M. & Co. of Calcutta for several years and were paid for their services on a commission basis. In 1926, B. M. & Co. gave notice to Katrak & Co., terminating their agency as they wanted to open their own branch at Karachi, and in consideration of the services rendered by Katrak & Co. in the past in helping B. M. & Co. to build up their business, the latter agreed to give Mr. Katrak a monthly allowance of Rs. 500 per month as long as he lived and

further agreed that, in the event of his death before the expiry of five years from the date of the termination of the agreement, they would continue this allowance to his son for the unexpired portion of five years. Katrak & Co., also agreed not to do any business in competition to that of B. M. & Co., during the continuance of the allowance. Held, *on a reference by the Commissioner, that the monthly allowance paid to Mr. Katrak was in the nature of a gratuity for services rendered, it clearly fell within the definition of "salary" in Sec. 7 of the Indian Income Tax Act and was assessable to income-tax.*

COMMISSIONER OF INCOME TAX, BENGAL *v.* SHAW WALLACE & Co., [I.L.R. 59 Cal. 1343] *distinguished.*

MAHARAJ KUMAR GOPAL SARAN NARAIN SINGH *v.* COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA (1935) (14 Pat. 552; 1935 I.T.R. 237) *applied.*

Cases referred to:

COMMISSIONER OF INCOME-TAX, BENGAL *v.* SHAW WALLACE & Co., [1932] (A.I.R. 1932 P.C. 138; 136 I.C. 742; 59 I.A. 206; 59 Cal. 1343; 1932 Comp. Cas. 276; 6 I.T.C. 178). [P.C.]

GOPAL SARAN NARAIN SINGH *v.* COMMISSIONER OF INCOME TAX, BIHAR & ORISSA [1935] A.I.R. 1935 P.C. 143; 156 I.C. 856; 62 I.A. 207; 14 Pat. 552; 1935 I.T.R. 237). [P.C.]

Case stated by the Commissioner of Income Tax, Bombay Presidency, under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922. [Ref. No. 137 of 1933.]

CASE

Case stated by the Commissioner of Income Tax, Bombay Presidency and Aden, under Sec. 66 (2) of the Indian Income-tax Act, XI of 1922, (hereinafter referred to as the Act) at the instance of Khan Bahadur K. H. Katrak of Karachi (hereinafter referred to as the assessee) for the decision of the Court of the Judicial Commissioner in Sind acting as the High Court for the Province of Sind for the purpose of the Act.

2. **Facts of the case**:—The assessee is a resident of Karachi. He and his son Sohrab were doing business under the style of Messrs. Katrak & Co. (hereinafter referred to as the "firm") and had besides income from several other sources too during the financial year 1931-32. For the purpose of the 1932-33 assessment he made a return of income under Sec. 22 (2) of the Act for the above year 1931-32 showing an income of Rs. 21,575-5-0 from various sources including a sum of Rs. 6,000 received by him from

The Imperial Chemical Industries India Ltd., (represented by Messrs. Brunner Mond & Co. Ltd. of Calcutta) which was shown under the head " Salaries." Against this item, however, a note was made stating " Allowance of Rs. 6,000 from the Imperial Chemical Industries India Ltd., was paid on account of termination of Agency Agreement which, however, is not liable to taxation." The Income Tax Officer, thereupon, gave a hearing to the assessee's pleader and on 28-2-1933 levied an assessment including this sum of Rs. 6,000 in the total income liable to tax. A copy of his assessment order is annexed hereto marked as Exhibit A.

3. Thereupon under the provisions of Sec. 30 (1) of the Act, an appeal was lodged by the assessee against the assessment in question and the Assistant Commissioner while modifying the assessment as regards certain other disputed items, confirmed the assessment order of the Income Tax Officer as far as this item of Rs. 6,000 was concerned. A copy of the appellate order is annexed hereto marked as Ex. B and it fully explains the reasons for including this item in the taxable income.

4. In order to make clear the nature of this item of Rs. 6,000, I give here its history. On 25-1-1911, Messrs. Brunner Mond & Co. Ltd., of Calcutta (hereinafter referred to as the Company) appointed Messrs. Katrak & Co. in which the assessee was the principal partner, their selling agents in Karachi on the basis of a commission of 2½ per cent. on sales effected through the latter firm. The agency was terminable at six months' notice. On 19-10-1926, such a notice was given terminating the agency from 30-4-1927. This was done, as the company wanted to open its own branch at Karachi for the sale of its products. While giving the aforesaid notice on 19-10-1926, it wrote a letter to Messrs. Katrak & Co. of the same date, explaining the real meaning of the notice given as under :—

" As we informed Khan Bahadur Katrak personally what we propose is not a complete severance of our long standing business relations with you, which in many respects have been ideal, *but a modification thereof*, as will be seen from the following summary of the arrangements agreed upon in Calcutta."

The summary of the arrangements made provides that Messrs. Katrak & Co., should act as the guarantee brokers of the Company on a commission of ½ per cent. on sales, that a monthly allowance of Rs. 500 be paid to the assessee in recognition of services rendered for a minimum period of 5 years from 1-5-1927 and that should he not survive the said period of five years, the allowance

be paid to his son who was the junior partner in the firm of Messrs. Katrak & Co. It was further stipulated that the firm was not to enter into any competition with the company as regards the sale of the latter's products while the above allowance was being paid etc.

A copy of this letter is annexed hereto marked as Ex. C.

5. Being dissatisfied with the Assistant Commissioner's decision, the assessee has by his petition dated 4-7-1933 (copy annexed marked as Ex. D) called for a reference to the High Court under Sec. 66 (2). This statement of the case is being submitted accordingly.

6. **Question for the decision of the High Court.**—I submit for the decision of the Honourable Court the following question, a decision of which will enable me to give all the relief prayed for by the assessee, in case the Honourable Court is pleased to answer it in his favour :

"Whether, in the circumstances of the case, the Income Tax Officer has correctly included the allowance of Rs. 500 per mensem in the total income of the assessee liable to tax for the financial year ended 31st March 1933."

7. **Opinion of the Commissioner** :—As Sec. 66 (2) of the Act requires me to state my opinion while forwarding the statement of the case, I beg to add here that in my opinion the answer to the question put must be in the affirmative as a perusal of the letter dated 19-10-1926 (Ex. C.) from Messrs. Brunner Mond & Co. Ltd., makes it quite clear that the monthly allowance of Rs. 500 has been paid in view of services rendered in the past and because of the continuation of certain business relations between the firm and the Company whereby the former undertakes *inter alia* not to enter into competition with the latter as regards the sale of certain articles as long as the allowance was being paid. There is no provision in the Act under which such an item of income in the shape of a monthly allowance to be regularly paid at least for five years can be exempted from the tax. It is not a capital receipt, as such an amount would be paid once and for all. Nor can it be regarded as a payment of a capital receipt by instalments as the capital sum involved is nowhere stated. Nor could such a capital sum be specified as the payment of the allowance is contingent on certain well defined factors and performance on the part of the assessee's firm of a certain act agreed to between the two parties concerned, *viz.*, not to enter into competition with the company as regards sale of certain goods. In the words of their Lordships

of the Privy Council in the case of *Commissioner of Income Tax, Bengal* v. *Shaw Wallace & Co.* the allowance of Rs. 500 per mensem is certainly nothing but "a periodical monetary return 'coming in' with not only some sort of regularity" but a definite regularity, as a result of the definite arrangement entered into with the Company as embodied in the letter Ex. C. It is thus an item of income liable to tax.

8. A copy of your Lordships' decision may kindly be certified to me for further action as required by Sec. 66 (5) of the Act."

Partabrai D. Punwani, for the Applicant.
Suganlal Hassanand, for the Opposite Party.

JUDGMENT.

RUPCHAND BILARAM, A. J. C.—This is a reference under S. 66 Cl. 2 of the Income Tax Act. There is no dispute about the facts. It appears that the firm of Messrs. Katrak and Co., which consists of Khan Bahadur Katrak and his son Mr. Sohrab Katrak acted as agents of Messrs. Brunner Mond and Co. Ltd. of Calcutta for sale of their products at Karachi and were paid for their services on a certain commission basis. The agreement between the parties provided that it was terminable at six months' notice. On 19th October 1926, Messrs. Brunner Mond & Co. Ltd., gave notice to Messrs. Katrak and Co., terminating their agreement from 30th April 1927, that is to say, at the expiry of full six months from the date of the notice. The reason for this was that Messrs. Brunner Mond and Co. Ltd., wanted to open their own branch office at Karachi. In consideration however of the services rendered by Messrs. Katrak and Co., for several years past in helping Messrs. Brunner Mond and Co., Ltd., to build up their business, the latter firm agreed to give K. B. Katrak a monthly allowance of Rs. 500 per month so long as he lived and further agreed that in the event of his death before the expiry of a period of five years from the date of the termination of the agreement, they would continue this allowance to his son for the unexpired portion of five years. They also appointed Messrs. Katrak and Co., as their guarantee brokers on payment of a small commission and stipulated that during the continuance of the monthly allowance and the continuance of the new agreement appointing them as guarantee brokers, Messrs. Katrak and Co., would not do any business in competition to that of Messrs. Brunner Mond and Co. Ltd. For a period of two years K.B. Katrak did not object to being

assessed on the allowance of Rs. 500 per month but subsequently it appears that in view of the ruling of their Lordships of the Privy Council in *Commissioner of Income Tax, Bengal* v. *Shaw Wallace & Co.*, he was advised to demur the income tax being levied upon this item, resulting in the present reference.

Now it is no doubt true that in the reference made by the Commissioner of Income tax he has relied upon several grounds which cannot be maintained, but it is hardly necessary to go into them. We are afraid the case of the assessee does not fall within the purview of the Privy Council ruling relied upon by him but it falls within the purview of a latter ruling of their Lordships of the Privy Council in *Gopal Saran Narain Singh* v. *Commissioner of Income Tax, Bihar and Orissa.* In that case the assessee had conveyed a greater portion of his estate in consideration of the vendee covenanting to pay (a) his debts, (b) a certain sum for the marriage expenses of the assessee's daughter, and (c) certain annual sums to him during his lifetime, and it was contended that the assessee was not liable in respect of the annual instalments *inter alia* on the ground that such instalments were not in the nature of an annuity but a capital sum being the purchase price of the property conveyed by him. In dealing with this case their Lordships have said:

"Their Lordships agree with the opinion expressed by the Chief Justice upon this point. The word 'income' is not limited by the words 'profits' and 'gains.' Anything which can properly be described as income is taxable under the Act unless expressly exempted. In their Lordships' view the life annuity in the present case is 'income' within the words used in the judgment of this Board in *Commissioner of Income Tax, Bengal* v. *Shaw Wallace & Co.*, at p. 212, *viz.*, 'income', their Lordships think, in this Act, connotes a periodical monetary return 'coming in' with some sort of regularity from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall. This income has been likened pictorially to the fruit of a tree or the crop of a field. It is essentially the produce of something which is often loosely spoken of as 'capital.' But capital though possibly the source in the case of income from securities, is in most cases hardly more than an element in the process of production. Here the source of the life annuity is the covenant. The life annuity is the produce

of one of the items (*viz.*, the covenant) which the appellant has taken in exchange for the estate."

The present case is even much stronger. The annuity secured to K. B. Katrak and his son was in the nature of a gratuity for services rendered by K. B. Katrak in building up the business of his employers. He had watered the tree which had grown and borne fruits. No doubt his firm was paid for watering the tree during the continuance of the agency and when that agency was being terminated he and his son were permitted to enjoy a part of the fruits of the tree provided of course they did not try to destroy the tree by entering into a competitive business. The produce of this tree which they were permitted to enjoy was indubitably income assessable as such.

In the Privy Council cases referred to above there is no reference to the definition of salary as given in S. 7, Income tax Act. In that section salary is defined as including not only what is originally known as salary but also wages and any annuity, pension or gratuity, fees, commissions, perquisites or profits received by the assessee in lieu of or in addition to any salary or wages. The agreement to pay a certain periodical sum of money during the lifetime of K.B. Katrak and in the event of his death before the expiry of five years from the date of the termination of the agency to his son for the unexpired period of five years falls clearly within the purview of S. 7 and is as such taxable income unless the assessee is able to bring his case within one of the exemptions contained in S. 4 Cl. (3) of the Act. Had the employers of the assessee given a lump sum to the firm of Messrs. Katrak & Co., or to K.B. Katrak in consideration of services rendered by that firm a good deal might have been said in favour of the assessee. But in the present case no such considerations apply. The assessee is being paid a fixed sum for his life and cannot therefore escape assessment. We accordingly answer the question propounded by the Commissioner of Income Tax in his favour by holding that the allowance of Rs. 500 per month is liable to income tax. The assessee has already deposited Rs. 100 with the Income Tax Commissioner to meet the costs of this reference and we order that the Income-tax Commissioner should have his costs as taxed by this Court provided such sum does not exceed Rs. 100. If the costs taxed are less, the assessee will no doubt get a refund from the Income-tax Commissioner of the balance.

Reference answered.

[IN THE MADRAS HIGH COURT.]

AR. PL. SP. MANICKAM CHETTIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS.

SIR H. O. C. BEASLEY, C. J., KING and GENTLE, JJ.

April 7, 1936.

FOREIGN INCOME—DEBT DUE FROM FOREIGN DEBTOR—ACCEPTING ASSIGNMENT OF DECREE IN BRITISH INDIA IN SATISFACTION OF DEBT—WHETHER AMOUNTS TO REMITTANCE OF ASSETS TO BRITISH INDIA—ASSESSMENT BEFORE DECREE AMOUNT IS REALISED—LEGALITY—INCOME—RECEIPT OF MONEY'S WORTH —INDIAN INCOME TAX ACT (XI of 1922), Sec. 4 (2).

The assessee who resided in British India owned a money-lending business in Penang (outside British India). This business had dealings with M. RM. VL., Penang, whose proprietor also resided in British India. On settlement of accounts it was found that M. RM. VL., owed 11,700 dollars for which the assesse took a promissory note. In the year of account the decree which the assessee had meanwhile obtained on the pronote was satisfied by the debtor giving to the assessee in British India jewels worth Rs. 7,842-12-0 and getting him an assignment of a decree obtained by a third person against the assessee's brother-in-law RM. M. RM. for Rs. 15,962-12-0. These amounts were credited in the assessee's headquarters accounts towards the debt due by M. RM. VL. The Income-tax authorities held that the transactions amounted to a receipt by the assessee of Rs. 23,835-8-0 and assessed him on the taxable profits included in this sum, even though the decretal amount had not been realised by the assessee from RM. M. RM. It was not alleged or proved that this decree was unrealisable or was not worth the amount for which it had been assigned to the assessee. Held, *on a reference by the Commissioner, that when the assessee accepted the jewels and took the assigned decree, the debt due to the Penang business was completely discharged; the assets of that business were diminished by Rs. 23,805-8-0 and there was a corresponding increase in the assessee's assets in British India; the transactions thus amounted to a remittance to British India of Rs. 23,805-8-0 from Penang and the assessee was rightly assessed in respect of the taxable profits included in this sum.*

Cases referred to:

CALIFORNIAN COPPER SYNDICATE *v.* HARRIS [1904] (5 Tax. Cas. 159; 6 F. 894).

RAJA RAGHUNANDAN PRASAD v. COMMISSIONER OF INCOME TAX, BIHAR & ORISSA [1933] (1933 I.T.R. 113; 14 P.L.T. 227; A.I.R. 1933 P.C. 101).

ST. LUCIA USINES AND ESTATES CO. v. ST. LUCIA COLONIAL TREASURER [1924] (1924 A.C. 508; 14 Tax. Cas. 603).

Case stated under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922) by the Commissioner of Income Tax, Madras [O.P. No. 286 of 1935].

STATEMENT OF CASE.

"I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922), hereinafter referred to as the Act.

2. **Facts of the case.**—The petitioner is the manager of a Hindu undivided family residing at Karaikudi within the jurisdiction of the Income Tax Officer, Karaikudi I circle. He owns properties, carries on money-lending business at Karaikudi (his headquarters), Penang and Parit Bunder and is a partner in a joint money-lending business at Razia and Parit Bunder. He also derives income from dividends.

3. The reference arises out of the inclusion of a sum of Rs. 10,900 treated as profits remitted from the Penang business, in the assessment made on the petitioner for the year 1934-35 (previous year 13-4-1933 to 12-4-1934).

The petitioner's Panang business had dealing in current account with M.RM.VL., Penang, a moneylending business, the proprietor of which was a resident in British India. On a settlement of this account on 13th August 1931 it was found that the debtor owed the petitioner 11,700 dollars for which he executed a promissory note in favour of the petitioner on that date. Subsequently, the petitioner obtained a decree against the debtor in the Devakotta Sub-Court for the amount due under the promissory note. In the year of account the debtor satisfied this decree by selling to the petitioner in British India jewels valued at Rs. 7,842-12-0 and agreeing to pay Rs. 15,962-12-0 to A.M.A. Kallal in consideration of which A.M.A. Kallal assigned in favour of the petitioner a decree obtained by him in British India against RM.M.RM., the petitioner's brother-in-law. These amounts, viz., Rs. 7,842-12-0 plus Rs. 15,962-12-0 or Rs. 23,805 were credited in the petitioner's headquarters accounts of the year of account towards the decree debt due by M. RM. VL. and corresponding

debits were made against (i) jewels purchase account and (ii) RM.M.RM. the judgment-debtor in the decree assigned in favour of the petitioner. Deducting costs of the suit (Rs. 3,206-5-1) the balance to the credit of the account in the name of M.RM.VL. is Rs. 20,599-2-11. No amount was collected by the petitioner in respect of the decree against RM.M.RM. in the year of account. The Income Tax Officer held that the above transactions amounted to a receipt by the petitioner in British India of Rs. 23,805-8-0 out of his funds in his Penang business and he computed the amount of taxable profits included in this sum to be Rs. 10,900. He accordingly included Rs. 10,900 in the assessment made on the petitioner for the tax year 1934-35.

4. The petitioner appealed to the Assistant Commissioner and contended among other things which are not relevant for the purposes of this reference that no amounts had so far been realised in respect of the decree assigned in favour of the petitioner and that the mere assignment of a decree cannot amount to a remittance of the amount covered by the decree within the meaning of Sec. 4 (2) of the Act. The Assistant Commissioner overruled the objection and agreed with the Income Tax Officer's finding. He accordingly dismissed the appeal. An extract from his order is filed as Exhibit A.

5. The petitioner now requires me to refer to the High Court 3 questions marked (a), (b) and (c) in the petition, alleged to be questions of law said to arise out of the Assistant Commissioner's order. Of these, I consider that questions (a) and (b) and the first part of question (c) are questions of fact. The only question of law arising on the facts of the case is the second part of question (c) and I accordingly refer that question for the decision of the Court.

Question.—Whether the assignment in British India of a British Indian decree in discharge of a debt of Rs. 15,962-12-0 due to the petitioner's foreign business will amount to an actual receipt in British India at the time of the assignment of money's worth from the foreign debtor, even though no money has been realised by the petitioner from the judgment debtor under the decree assigned.

6. **Opinion.**—Money can be received in more ways than one. The petitioner himself admits that a receipt in kind may amount to receipt of money provided what was received is equivalent to cash or money's worth. It is not the petitioner's case that the decree in question is unrealisable or that it is not worth the amount for

which the petitioner got it assigned in his favour. The debt due by M.RM.VL. to the Penang business has been completely discharged by the sale of the jewels and the assignment of the decree. The petitioner's assets in Penang have therefore undergone a diminution to that extent and a corresponding increase has been made in the assets of the headquarters. That, in my opinion, amounts to receipt of value in British India. The fact that part of the debt is now due from another debtor does not mean that the old debt has not been realised. The effect of the transaction is that the petitioner recovered the debt due by the Penang debtor, *viz.*, M.RM.VL. and lent part of the money recovered to a new debtor in British India, *viz.*, RM.M.RM., the judgment-debtor under the decree assigned in favour of the petitioner. I am therefore of the opinion that the sum of Rs. 15,962-12-0 was actually received by the petitioner in British India. The question should be answered accordingly."

K. Rajah Aiyar for the assessee.

M. Patanjali Sastri for the Crown.

JUDGMENT.

THE CHIEF JUSTICE.—In this reference the facts are shortly as follows: The assessee is the manager of an undivided Hindu family and, *inter alia*, owns a money-lending business in Penang which is outside British India. This business had dealings in current account with M. RM. VL., Penang, the proprietor of which was resident in British India. On the 13th August 1931, it was found on a settlement of this account that there was a sum of 11,700 dollars owing to the assessee. In discharge of this amount M.RM.VL. executed a promissory note in favour of the assessee. Later, the assessee obtained a decree against the debtor in the Devakottah Sub-Court for the sum due on this promissory note. In the year of account this decree was satisfied by the debtor selling to the assessee in British India jewels valued at Rs. 7,842-12-0 and agreeing to pay Rs. 15,962-12-0 to A. M. A. Kallal in consideration of which A.M.A. Kallal assigned in favour of the assessee a decree obtained by him in British India against RM.M.RM., who is in fact the brother-in-law of the assessee. These amounts of Rs. 7,842-12-0 and Rs. 15,962-12-0, a total of Rs. 23,805 12-0 were credited in the assessee's headquarters accounts at Karaikudi of the year of account towards the decree debt due by M.RM.VL. and corresponding debits were made against (1) jewel purchase account and (2) RM.M.RM., the

judgment debtor in the decree assigned in favour of the assessee. No amount was collected by the assessee in respect of the assigned decree in the year of account but the assessee admitted before the Commissioner of Income Tax that a receipt in kind may amount to receipt of money provided what is received is equivalent to money or is money's worth. He did not contend that the assigned decree was unrealisable or was not worth the amount for which it was assigned to the assessee.

The Income Tax Officer held that the above transactions amounted to a receipt by the assessee in British India of Rs. 23,895-8-0 out of funds in his Penang business. Out of this sum the Income Tax Officer computed the taxable profits to be the sum of Rs. 10,900 and accordingly this amount was included in the assessment made upon the assessee for the tax year 1934-35. The assessee appealed to the Assistant Commissioner and contended that no monies had so far been realised in respect of the assigned decree and that the mere assignment of the decree cannot amount to a remittance of the amount covered by the decree within the meaning of Sec. 4 (2) of the Act. The Assistant Commissioner dismissed the appeal. The Commissioner has now referred to us for our decision the following question: "Whether the assignment in British India of a British Indian decree in discharge of a debt of Rs. 15,962-12-0 due to the petitioner's foreign business will amount to an actual receipt in British India at the time of the assignment of money's worth from the foreign debtor even though no money has been realised by the petitioner from the judgment debtor under the decree assigned."

Money can be received in more ways than one and when the assessee accepted the jewels and took the assigned decree the debt due to the Penang business was completely discharged and the assets of that business were diminished by, and there was an increase in the assessee's assets in British India of, the sum of Rs. 23,805-8-0. It was argued before us that as the amount of the assigned decree had not been received from the judgment debtor, the amount of decree should not be taken into consideration when arriving at the sum for assessment. Assuming that no such moneys had been received, even then the assessee had by the transactions mentioned transferred into British India assets which he could, and in respect of the jewels in fact did, realise and he could have realised the assigned decree at any time. In our view, these transactions amount to remittance into British India of moneys or money's worth. Several cases were cited to us by the assessee's counsel—

amongst them *Californian Copper Syndicate* (*Limited and Reduced*) v. *Harris*; *Raja Raghunandan Prasad Singh* v. *Commissioner of Income Tax, Bihar and Orissa* and *St. Lucia Usines and Estates Co.* v. *St. Lucia* (*Colonial Treasurer*). None of these authorities in any way assist the assessee's contention. On the contrary, in the first of the above cases, LORD TRAYNER at page 167 says: "A profit is realised when the seller gets the price he has bargained for. No doubt here the price took the form of fully paid shares in another company, but, if there can be no realised profit except when that is paid in cash, the shares were realisable and could have been turned into cash, if the appellants had been pleased to do so. I cannot think that income tax is due or not according to the manner in which the person making the profit pleases to total with it." This is directly opposed to the assessee's contention; and our answer to the question referred to is "yes". The Income Tax Commissioner will get Rs. 250 costs.

Answer accordingly.

[IN THE BOMBAY HIGH COURT.]

COMMISSIONER OF INCOME TAX, BOMBAY
v.
MAKANJI LALJI.

SIR J. W. F. BEAUMONT, C.J., and BLACKWELL, J.

March 25, 1937.

HINDU UNDIVIDED FAMILY—ALLOWANCE FOR MAINTENANCE PAID TO WIDOW OF DECEASED COPARCENER UNDER DECREE OF COURT CHARGING FAMILY PROPERTY—WHETHER DEDUCTIBLE—INDIAN INCOME TAX ACT (XI of 1922), SEC. 3.

In computing the income of a Hindu undivided family for purposes of income tax, moneys paid to the widow of a deceased coparcener of the family as maintenance and residence allowance cannot be deducted, even though the amount of such allowance has been fixed by a decree of the Court and has been made a charge on properties belonging to the family.

Cases referred to:

RAJA BEJOY SINGH DUDHURIA *v.* COMMISSIONER OF INCOME TAX, BENGAL [1933] (1933 I.T.R. 135; 35 Bom. L.R. 811; 60 I.A. 196; 60 Cal. 1029; 143 I.C. 145; 6 I.T.C. 459) *distinguished.*

VEDATHANNI *v.* COMMISSIONER OF INCOME TAX, MADRAS [1932] (56 MAD. 1; 1933 I.T.R. 70; 63 M.L.J. 542; A.I.R. 1932 MAD. 733; 140 I.C. 70) *referred to.*

STATEMENT OF CASE.

"Under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922, (hereinafter referred to as "the Act") and at the instance of Mr. Kalianji Makanji, the head of a Hindu undivided family carrying on business in the name of Makanji Lalji (hereinafter referred to as "the assessee"), I have the honour to refer to your Lordships for favour of decision on the questions of law categorically set out in para 5 below arising out of the income tax assessment of the assessee for the financial year 1935-36 ended on 31st March 1936.

2. **Facts of the case.**—The assessee is a Hindu undivided family and carries on business in camphor etc., and his income from interest and house property at Cathedral Street in Bombay city.

For the financial year 1935-36 ended on 31st March 1936, the Assistant Income Tax Officer, Bombay, determined the assessee's total income for the Hindu Samvat year 1990 (which was the 'previous year' as defined under Sec. 2 (4) of the Act) at Rs. 9,638 as under:

(*a*) Property	...	Rs.	4,767
(*b*) Business	...	Rs.	4,534
(*c*) Other sources (Interest)	...	Rs.	337
		Rs.	9,638

At one time, the joint family consisted of the above Mr. Kalianji Makanji and his brother Mathuradas Makanji. The latter died several years ago leaving a widow named Nambai. She brought a suit (No. 1251 of 1928) against the said Kalianji and his minor son Liladhar in 1928 and obtained a consent decree (Ex. A) from the High Court dated 29th January 1930, under which she was given a lump sum of Rs. 15,000 and was to be paid a further sum of Rs. 165 as "maintenance and residence allowance." It was also provided in the decree that the immovable property referred to at (a) above belonging to the joint family "do stand charged in favour of the plaintiff with the said monthly payment of Rs. 165 payable to her as aforesaid." In view of this, it was claimed that in computing the assessee's income from property a reduction should be allowed therefrom to

the extent of Rs. 2,145 on account of the above payment of Rs. 165 per mensem for 13 months of the Samvat year 1990 as the said payment was, under the decree, a charge on the property under assessment. It was also claimed that to the extent of this sum, the income of the property was diverted to the said Bai Nambai and so did not form any part of the assessee's income in view of the decision of the Privy Council in the case of *Raja Bejoy Singh Dudhuria* (60 I.A. 196). The Assistant Income Tax Officer did not allow the claim on the ground that the widow continued to be a member of the Hindu undivided family and that the maintenance allowance paid to her was received by her as such member of the Hindu undivided family and he relied on the case of *Vedathanni* v. *Commissioner of Income Tax, Madras*, (56 Madras 1). A copy of the assessment order dated 23rd December 1935 passed by him is annexed hereto and marked B.

3. The assessee thereupon appealed to the Assistant Commissioner by petition dated 29th January 1936 signed by Kalianji Makanji, a copy of which is hereunto annexed and marked C. The Assistant Commissioner, after hearing the appeal, confirmed the assessment by his order dated 19th February 1936 (a copy annexed hereto and marked D). He too held that the widow was a member of the family and that there was no authority under Sec. 10 (2) (ix) to grant any such deduction. The Assistant Commissioner held that the decision of the Privy Council in the case of *Raja Bejoy Singh Dudhuria* did not apply and that the case was governed by the Madras High Court decision in the case of *Vedathanni* v. *Commissioner of Income Tax, Madras*.

4. Being aggrieved with the Assistant Commissioner's decision, an application by petition dated 30th March 1936 (a copy annexed hereto and marked Ex. E), was made to me requesting me to refer to your Lordships the questions of law set out there in or whatever other questions I may frame for reference and I accordingly submit this Statement of the Case to the Hon'ble Court for favour of decision.

5. **Questions for the Decision of the Hon'ble Court** :—I submit for decision the following questions of law :—

(1) In the circumstances of the case, has the Income Tax Officer correctly computed the income from house property at Rs. 4,767 ?

(2) Is the assessee entitled to any deduction from the above income of Rs. 4,767 of Rs. 165 per mensem paid to Bai Nambai on account of "maintenance and residence allowance" under the

consent decree in High Court Suit No. 1251 of 1928?

6. **The Opinion of the Commissioner** :—As Sec. 66 (2) of the Act requires me to give my opinion while submitting the Statement of the Case, I beg to state that in my respectful opinion, the answer to question 1 should be in the affirmative and that to question 2 in the negative. The assessee is an undivided Hindu family as stated in paragraph 2 above. Under the Hindu Law, the widow Nambai being a member of this family was entitled to maintenance allowance and owing to a dispute with the other members of the family, she resorted to the High Court and got a consent decree passed for the payment of the sum in dispute, *viz.*, Rs. 165 per mensem on account of "maintenance and residence allowance". Simply because she resorted to a Court of Justice to enforce her right as a member of the family, it does not follow that she ceased to be a member of the family, and the very fact that she continues to receive maintenance shows that she continues to be a member of the undivided family under assessment. As it is the undivided family that is under assessment, the payment of Rs. 165 per month merely amounts to the enjoyment of the income of the family by a member thereof and there can be no question whatever of deducting any amount spent by the family on any members as in case that could be done, there would be hardly anything left to be taxed not only in the case of these undivided Hindu families but in the case of most of the assessees who have all to spend what they earn on the maintenance of themselves and members of their family. The claim put forward is on this account wholly untenable.

7. A copy of your decision may kindly be certified to me for further action as required by Sec. 66 (5) of the Act."

The Advocate General with the *Government Solicitor* for the Commissioner of Income Tax.

C. K. Daphtary with *Messrs. Vatcha & Co.* for the Assessees.

JUDGMENT.

BEAUMONT, C. J.—This is a reference by the Commissioner of Income Tax under Sec. 66 (2) of the Indian Income Tax Act. The question is whether certain allowances, ought to be given to the assessee. The assessee is a Hindu undivided family. Originally the family consisted of a father and two brothers, the father died, and then one of the brothers named Mathuradas died leaving a widow named Nambai. Then the other brother Kalianji became the sole surviving coparcener. He has got a son, so that the coparcenary now consists of Kalianji and his son, and the widow

of Mathuradas is a member of the joint family in her capacity as a widow of a deceased coparcener. She applied to the Court for maintenance at the rate of Rs. 165 per mensem, and the question is whether the sum can be deducted from the assessable income. Now, inasmuch as the assessee is the Hindu undivided family which includes this widow, it is difficult to see how any deduction can be allowed in respect of a share of the income going to one of the members of the joint family, and I think there is no ground for the contention that the decree which fixes the amount of the maintenance alters the character of the sum which the widow receives, which is still maintenance paid to her as a widow in a joint family, although the amount is fixed by the decree. Mr. Daphtary relies on the decision of the Privy Council in *Raja Bejoy Singh Dudhuria* v. *Commissioner of Income Tax.* In that case there was a surviving male member of a joint family, and his step-mother had obtained a decree for maintenance. It appears from the report that the Advocate General abandoned the contention that the appellant and his step-mother were members of the undivided Hindu family, and accepted the position that the appellant was liable to be assessed as an individual and in no other manner, and what the Privy Council held was that the assessee being an individual, the sum which he had to pay out of income to his step-mother never formed part of his income. It had been diverted to the step-mother before the income came to the hands of the assessee and on that basis he was allowed a deduction in respect of the maintenance. But in this case the assessment being on a Hindu undivided family the whole of the income of the Hindu undivided family is liable to assessment, and it is impossible to deduct this sum payable to the widow of a deceased brother, who gets it in her capacity ultimately as a member of the joint family. I think, therefore, that the first question, "In the circumstances of the case, has the Income Tax Officer correctly computed the income from the house property at Rs. 4,767" should be answered in the affirmative, and the second question "whether the assessee is entitled to any deduction from the above income of Rs. 4,767 in respect of Rs. 165 per mensem paid to Bai Nambai on account of maintenance under the consent decree" should be answered in the negative. Assessee to pay the costs of the Commissioner of Income Tax on the Original Side scale to be taxed by the Taxing Master less Rs. 100.

BLACKWELL, J. :—I agree, and have nothing to add.

Answers accordingly.

[IN THE ALLAHABAD HIGH COURT.]

COMMISSIONER OF INCOME TAX, U. P.

v.

TIKA RAM & SONS LTD.

SIR S. M. SULAIMAN, C. J., HARRIES, J., and BAJPAI, J.

July 26, 1937.

BRICKFIELD—COST OF EARTH DUG UP FROM FIELD—WHETHER ALLOWABLE AS BUSINESS EXPENDITURE OR DEPRECIATION OF PROPERTY—INDIAN INCOME TAX ACT (XI of 1922), SEC. 10 (2) (ix).

The assessee was a limited company carrying on the business of manufacturing bricks. It owned as proprietor a part of the land from which earth was taken for the manufacture of bricks and it also held a lease of the other portion of the land. It claimed that a sum of Rs. 2,500 representing the value of the earth used up in the manufacture of bricks during the year of account should be deducted in computing its income for purposes of income tax, as depreciation of property or business expenditure: Held, *on a reference by the Commissioner, that the assessee was not entitled to the deduction claimed.*

The case of a brickfield is very similar to that of a quarry or mine and the proprietor of the land or the lessee is not a mere purchaser of raw materials but a person who has acquired certain rights in the land, and the amount invested by him must, therefore, be treated as capital expenditure within the meaning of Sec. 10 (2) (ix).

Cases referred to:

ALIANZA COMPANY *v.* BELL [1904, 2 K.B. 666 : affirmed by the Court of Appeal in 1905, 1 K.B. 184 and by the House of Lords in 1906 A.C. 18; 75 L.J.K.B. 44; 5 Tax Cas. 172).

GOLDEN HORSE SHOE (NEW) LTD. *v.* THURGOOD [1934] (1 K.B. 548; 150 L.T. 427; 103 L.J.K.B. 619; 18 Tax Cas. 280).

JOHN SMITH & SON *v.* MOORE [1921] (2 A.C. 13; 12 Tax Cas. 266; 37 T.L. R. 613; 125 L.T. 481; 90 L.J.P.C. 149).

Case stated by the Commissioner of Income Tax, U. P. and C. P., under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922). Mis. Case No. 97 of 1936.

K. Verma for the applicant.

Panna Lal for the opposite party.

JUDGMENT.

This is a reference by the Commissioner of Income-tax under Sec. 66 (2) of the Indian Income-tax Act (XI of 1922). Tika Ram & Sons Ltd., the assessee, is a company carrying on the business of manufacturing bricks. It owns as proprietor a part of the land from which earth is taken for the manufacture of bricks and it also holds a lease of a portion of such land. It claimed that a sum of Rs. 2,500 representing the value of the earth used up in the manufacture of bricks during the year in question should be deducted as depreciation of its property. Later the position taken up was that it was expenditure incurred solely for the purpose of earning profits or gains within the meaning of Sec. 10 (2) (*ix*) of the Income-tax Act. The question referred to the High Court is whether the applicant is entitled on these facts to a deduction of the amount claimed as expenditure on account of the price or value of the earth dug and utilised for manufacturing bricks from the total profits of the business or otherwise as a depreciation in the value of the land.

If the company had been purchasing merely raw materials for the purpose of manufacturing bricks, it would certainly have been entitled to a deduction of the price of such materials from the total income realised by the sale of the bricks during the year. But the position here is not that of a company which is merely carrying on the business of manufacture by purchasing raw materials and converting such materials into marketable commodities.

The company is the owner and proprietor of a part of the land on which this business is carried on and has also taken a lease of the other [part] of the same land. The company therefore has both proprietors' and lessees' rights in the land itself and is in possession of such land and is also entitled to dig up earth out of this land and use the same for moulding bricks. In the process of manufacture, the subject of the lease is really not completely consumed or exhausted, but as earth is dug out fresh earth or clay becomes available, though there may possibly be a greater inconvenience or difficulty in digging out earth from a lower level. But it cannot be regarded as a case where the materials are completely and wholly used up in the process of manufacture. Here fresh materials of the same kind are for all practical purposes substituted for those taken out from the ground. The company by taking this lease has not purchased so many maunds of earth for so many rupees but has acquired lessee's rights in the immovable property which

includes the right to dig out earth and use it for the purpose of manufacturing bricks. The position seems to me more analogous to that of a company which is working a quarry or mine rather than to an ordinary manufacturer who purchases raw materials for the purpose of his manufacturing business. In the latter case the taxable income is the net gain or profit made by him which necessarily is the difference between the amount realised by him and the total amount spent by him; whereas in the case of a lessee of a mine, quarry or brick-field, the property already exists and is taxed as realised property yielding a certain annual income to the owner or lessee.

No case which is directly in point has been cited before us by the learned counsel, but there are observations in several English cases which show that the value of the materials found in a brick-field is treated as capital expenditure in England and is therefore not allowed to be deducted from the total income. The leading case is that of *Alianza Company* v. *Bell*. That was a case where an English Company was the owner of land in Chili containing deposits of caliche from which by a certain process nitrates and iodine were extracted. The process of manufacture would ultimately result in the exhaustion of the whole of the caliche available in which event the land and the machinery and plant used for the purpose of manufacture would be practically of no value. CHANNELL, J., pointed out that the case was one of those cases in which the process necessarily exhausts the material as the undertaking necessarily consumed in the course of its working the stock upon which it started. At p. 673 (of 1904, 2 K. B.) the learned Judge observed :—

"If it is merely a manufacturing business, the procuring of the raw material would not be a capital expenditure. But if it is like the working of a particular mine or bed of brick earth, and converting the stuff worked into a marketable commodity, then the money paid for the prime cost of the stuff so dealt with is just as much capital as the money sunk in machinery or buildings."

At p. 674 the learned Judge further pointed out that the position was similar to that of a mining company and it would make no difference whether the whole business was considered as consisting of two distinct businesses or of one business only, for in the former case the mining company would have to be credited with receiving the price of the raw material handed over to the manufacturing company if there were supposed to be two distinct businesses. This view was upheld by the Court of Appeal in

Alianza Company v. *Bell*, (1905, 1 K.B. 184) and was affirmed by the House of Lords in *Alianza Company* v. *Bell* (1906 A.C. 18).

In the case of *John Smith & Son* v. *Moore*, the assessee had after the death of his father acquired a certain business and taken over the assets at a valuation, which assets inclued certain forward coal contracts made by his father with several colliery owners for the delivery of coal. The coal contracts had been valued at £ 30,000. The assessee claimed that in arriving at the amount of the profits of the business chargeable to Excess Profits Duty the value of the contracts should be deducted. The House of Lords by a large majority overruled this contention. At p. 38, LORD SUMNER observed :—

"The business carried on was not that of buying and selling contracts but of buying and selling coals, and the contracts, which enabled the seller of the coals to acquire the coals, were no more the subject of his trading as a stock in trade for sale than a lease of a brick-field would be the subject of a sale of bricks."

It was further assumed that in the case of a lease of a brick-field the materials could not be treated as stock in trade for the purposes of assessment.

In the recent case of *Golden Horse Shoe (New) Limited* v. *Thurgood* the assessee was a company which had been formed for the purpose of acquiring the right to take away and re-treat very large dumps of residual deposits resulting from the working of a gold mine. LORD HANWORTH, M. R., approved of the view expressed by CHANNELL, J., in the case of *Alianza Company* v. *Bell*, and quoted the opinion of the learned Judge at considerable length. ROMER, L. J., also pointed out the distinction that has to be drawn between fixed capital and circulating capital, and said at page 564 that if a gas manufacturer, instead of buying his coal from outside sources, purchases a coal mine and produces the coal that he requires by mining, he would not be entitled to debit his profit and loss account with the sum by which the value of his mine has depreciated in consequence of the extraction of that coal, for the mine is regarded as being fixed capital. He then observed :—

"If .... instead of buying the mine, the gas manufacturer had brought a quantity of coal already extracted from the mine and stacked on the surface, the price of the coal would have been regarded as part of the circulating capital.... In such a case the purchase of the mine is not the purchase of coal but a purchase of land with the right of extracting coal from it. The land

is regarded merely as one of the means provided by the manufacturer for causing coal to be brought to his gas works, and therefore as much part of his fixed capital as would be any railway trucks or lorries provided by him for the same purpose."

The distinction made in *John Smith's* case was then quoted.

It therefore seems that the case of a brick-field is very similar to that of a quarry or a mine and the proprietor of the land or the lessee is not a mere purchaser of raw materials but a person who has acquired certain rights in the land and the amount invested by him must therefore be treated as capital expenditure within the meaning of Sec. 10 (2) (*ix*). The present assessee has agreed presumably to pay some premium and an annual rent for all his rights under the lease, and he or his predecessor might have paid the price of the land purchased. He has really not purchased any raw materials for cash and he cannot be allowed to claim a deduction of the supposed value of the earth taken out of the land as part of the property.

The answer to the question referred to us is therefore in the negative.

We direct that the assessee should pay the costs of Government and we assess the Crown counsel's fee at Rs. 200. We allow six weeks' time to the Crown counsel to file the certificate.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

SARDAR KIRPAL SINGH AND OTHERS
v.
COMMISSIONER OF INCOME-TAX, PUNJAB.

DALIP SINGH and SKEMP, JJ.

May 4, 1937.

HINDU UNDIVIDED FAMILY—CONVERSION INTO LIMITED COMPANY—POWER OF INCOME TAX AUTHORITIES TO FIND THAT TRANSACTION WAS MERE CAMOUFLAGE, AND ASSESS AS HINDU JOINT FAMILY—NOTICE—NOTICE AS INDIVIDUALS—ASSESSMENT AS JOINT FAMILY—LEGALITY—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 22, 25-A.

When a Hindu joint family constitutes itself into a company with specific shares belonging to the individual members and fur-

ther introduces into the company persons who are not members of the undivided joint family, the normal supposition would be that the Hindu joint family has disrupted. This normal supposition may be rebutted by evidence showing that the whole of the transaction was a mere camouflage, but the mere fact that the credit amounts in the personal khatas *were equalised does not conclusively show that the joint family still exists in a disguised form. [Their Lordships held on the facts of the case that there was not sufficient material for the income tax authorities to come to the conclusion that the Hindu joint family had not been disrupted.]*

Quaere: *Whether where notice is issued to certain individuals as such it is open to the income tax authorities to assess them as a Hindu undivided family without issuing of a fresh notice to the Hindu undivided family through the person whom they consider to be the manager or through any other adult member of the family. At any rate the view that it would be impossible to work the Act if a fresh notice is necessary in such a case is incorrect.*

JUDGMENT.

Case stated by the Commissioner of Income Tax, Punjab, under Section 66 (3) of the Indian Income Tax Act (XI of 1922) [Civil Ref. No. 14 of 1937].

M. C. Mahajan for the assessees.

J. N. Aggarwal for the Commissioner of Income Tax.

DALIP SINGH, J.—The facts of this reference are stated at length in the order of reference of the learned Commissioner and need only be briefly recapitulated here.

It appears that one Jawanda Mal was carrying on a business. He was presumably a member of a joint Hindu family along with his sons. In March 1927 or thereabouts, Jawanda Mal formed the intention of giving all the cash assets of the business to a limited liability Company of which, it is stated, he himself and three of his sons originally were to be the main shareholders. A portion of the cash assets left over was to stand in the name of the wife of Jawanda Mal as a loan to the company and she was given a share in the Company and the remaining three persons necessary to constitute a company consisted of the wives of the three sons. Subsequently, when the company came to be registered, it is again alleged, though it is not conceded on the part of the Income Tax Authorities, that one son Balwant Singh, who had been absent in England, was also given a share. Jawanda Mal divested himself

of a considerable portion of his share in this fashion in favour of his four sons, a small amount being retained by himself in his own name. The four sons had equal shares practically except that one Balwant Singh had 495 shares to the others son's 496. The wives had only one nominal share each. Shortly after this, Jawanda Mal died and the shares standing in his name continued to stand as before. The sons or some of them who as directors drew salaries and one minor son, it appears, did not draw any salary. In the books of the Company each son had a personal *khata* in which credits and debits were entered to his personal account. It would appear from the above statement that seemingly, at any rate, the Hindu joint family had disrupted and had been replaced so far as the cash assets of the business were concerned, by a limited liability Company consisting of eight members.

It is alleged now on behalf of the income tax authorities that this was mere camouflage and that really the Hindu joint family did not disrupt and the nominal shares assigned to the mother and the wives of the three sons were all *benami* to camouflage the continued existence of the undivided Hindu joint family. However, from 1927 on to 1933, that is, for six years, the sons of Jawanda Mal were assessed on the basis of a disruption of the joint Hindu family as separate individuals. In 1934-35 assessment the Income Tax Officer, however, appears to have, for the first time, suspected that the Hindu joint family still subsisted. It is unnecessary to enter at any great length into the reasons given by the Income Tax Officer for this conclusion. They have been upheld in the main by the Assistant Commissioner on appeal and by the learned Commissioner in the order of reference.

The main point, however, that emerges from the arguments addressed to us appears to be that in 1933, in spite of the fact that the personal *khatas* of the sons containing varying amounts standing to their credit due to the fact that they had drawn different amounts for their personal expenditure if any, were yet by some means equalised in the books of the company so that the same sum was shown as standing as a credit balance in favour of the three sons. It is, therefore, contended on behalf of the income tax authorities that there was some material for the Income Tax Officer to come to the conclusion that the four sons of Jawanda Mal still formed a joint Hindu family. On the other hand, on behalf of the assessee, it is contended that when the question arises whether a Hindu family has disrupted or not and when the point at issue is whether those individual members of that joint Hindu

family have continued as a partnership, that is to say, a tenancy in common instead of the previous joint tenancy, then the mere fact that some evidence exists to show a tenancy in common is not sufficient to prove that a joint tenancy still exists.

The question that really arises for decision may be put in the form of an illustration. If it is alleged by any person that he was once a member of a joint Hindu family but has since separated and has no connection with the other members of that joint Hindu family normally, and it is proved that as a matter of fact he still resides in the same house with them and has a secret partnership with them in all their seemingly separate business, this would be good material for holding that the Hindu family which was alleged to have disrupted has not really disrupted at all. The question, however, is obviously quite different when the individual who alleges a separation asserts that he has separated from a joint Hindu family but has continued as a partner along with the other members or some of the members of that joint Hindu family. Evidence which in the first case might very well be held to be good material for holding that the alleged disruption was false would not be good enough evidence in the second case for showing that the alleged disruption was similarly false. In this particular case the mere fact that the credit amount in the personal *khatas* were equalised does not, in my opinion, show conclusively that the Hindu joint family existed in a disguised form. After all when a Hindu joint family or the members thereof constitute themselves into a company with the assets of the joint Hindu family, they do create a situation in which ordinarily speaking, the rights and liabilities of the members *inter se* have altered considerably. For instance, in the case of a father, the sons who won a share in the company can alienate that share without reference to the father, thus practically securing a partition which, according to the law in this province, they could not do if they constituted a joint Hindu family during the life-time of the father without his consent. Secondly, the *karta* of the family would be liable to account to the members of the company for all expenditure and income received by the company whereas if the Hindu joint family existed the *karta* would not be so liable to account under normal conditions. Therefore when a Hindu joint family constitutes itself into a company with specific shares belonging to the individual members and further introduces into the company persons who are not members of the undivided joint Hindu family, the normal supposition would be that the transaction

showed that the Hindu joint family had disrupted. It is, of course true that this normal supposition could be rebutted by evidence showing that the whole of this transaction was a mere camouflage. But in the present case when for six years the income-tax authorities had themselves adopted the supposition as being genuine, there must be strong evidence to show that the transaction was really not *bona fide*. As stated above, all that could be relied on by the income tax authorities in this case was the equalisation of the credit amount in the personal *khatas*.

The learned counsel for the assessee has explained that what happened in this case was that one of the minor sons who had been away in England from 1929 returned in 1933 and raised some disputes as to the expenditure and income of the Company by which his brothers or one of his brothers, according to him, profited at his expense and that to avoid a family dispute and the laborious task of going into the accounts for over six or more years, the brothers decided to settle the matter by equalising all the credit amounts in the personal *khatas* so as to give a fresh start to all the individual members of the family. Here again, normally speaking, the equalisation of four accounts would naturally show that four accounts really existed and therefore the first supposition would be that these four accounts really existed as four separate accounts. If this were so, then, of course, the Hindu joint family could not be said to exist. Now, it cannot be said that four accounts did not really exist merely because the credit amounts of all the four accounts had by some process of agreement between the parties been equalised. The matter is at least capable of other explanations, and I must add that, in the circumstances of this case, if the Income-tax Officer had reason to believe that this was a suspicious circumstance it was only fair to call upon the assessee to explain, if possible, the suspicious circumstance arising in the mind of the Income-tax Officer and then to either accept or reject his explanation. All that appears to have been done was that the Income-tax Officer wrote a letter demanding proof of disruption to which the four brothers replied with duplicate letters stating the facts about the Company and about the joint partnership in two foreign concerns. It does not appear that they were ever called upon to explain their accounts in the light of the hypotheses that they were separate and not joint. This being so, I am of opinion that in the circumstances of this case, there was no sufficient material, for the Income-tax Officer to come to the conclusion that the Hindu joint family had not been disrupted. This finding really

disposes of the whole case, but for completeness, it is desirable in my opinion, to give findings on the other points raised also.

The next question is whether interest on loan is really a *benami* transaction, the asset really not belonging to the mother as shown in the books but belonging to the undivided joint Hindu family. There is no material at all upon this point to which our attention has been drawn except that it is stated that the fact that there is an accumulation of interest on the account standing in the name of the mother shows that the mother has never drawn upon the interest accruing to her from the alleged loan and that therefore this proves that the asset really belonged not to the mother but to the four sons. I am again unable to hold that this conclusively proves or even points to the conclusion reached. A Hindu widow on good terms with her sons would normally have no occasion to draw any money. There is nothing to show that the mother is living separate from her sons and an orthodox widow might well have no dealings with money at all and would allow the interest on her shares to accumulate not because it does not belong to her, but because she had no need to draw on it and the sentiments of the people would be against her personally handling money in the state of widowhood. Moreover, it is not proved that she has never drawn any portion of the so-called interest on her loan. It is only an assumption that because there is an accumulation of interest in her name therefore she has never drawn any portion of it at all. Under these circumstances I am unable to hold that the loan which was given by the mother to the company was really not a *bona fide* transaction, and, as a matter of fact, she held no money at all and that there is no loan item by her to the company and that the item really belongs to the undivided Hindu joint family.

The next point raised is the question of remittances from two foreign firms, one in London and one in Colombo, to the Company. It is contended that the books of the Company show that cash and goods were remitted both by the Company to these foreign businesses and cash and goods were remitted by the foreign businesses to the company and from this it is contended it was open to the Income-tax Officer to draw the inference that some of these remittances were really disguised profits. Now, no doubt, it might be open to the Income-tax Officer to draw the inference that the remittances to the Company contained disguised profits, but it would not follow from that that these remittances were really to the members of the undivided joint Hindu family

unless it was further held that the Company itself was nothing more than a camouflage for the undisrupted Hindu joint family. The matter, therefore, comes back to the first question upon which it has already been held that there is no sufficient material to show that the Hindu joint family was not disrupted and that the Company was nothing more or less than a camouflage for it. The answer, therefore, to this question must also be that there was no material to justify the Income-tax Officer in holding that an item of Rs. 10,000 charged as an asset of the Hindu joint family as disguised profits by way of remittances really existed.

The last question raised in the order of reference is the question of the notice to the firm. It was urged originally, when the case first came before the High Court, that the notices having been issued to the individual members of the family as such it was not open to the Income-tax Officer without issuing a new notice to the Hindu joint family through its manager or any adult member of the family to charge the income received by the individuals as income of the joint Hindu family. I do not consider that it is necessary to decide the point at all. It is true that the High Court issued a *mandamus* to the Commissioner to refer this question of notice also. The learned Commissioner has given reasons for holding that the notice, as originally issued, contained a heading 'family' as well as a notice to the individuals. A notice has actually been produced before us and it does not appear to contain any address 'family' in it at all. It is impossible for us to decide on the material before us whether this is the notice that was served on the individual members or not. I should, however, like to point out that the second argument of the learned Commissioner, namely, that it would be impossible to work the Act, if a notice issued to an individual as such could not form the basis of an assessment of the same individual along with others as members of a joint Hindu family, does not appear to be correct. It would be perfectly easy for the Income-tax Officer, if he came to the conclusion that the separate individual to whom he had issued notice really was a member of a joint Hindu family, to issue a fresh notice to the joint Hindu family, through the person whom he considered to be its manager or through any other adult member of the family as provided in Sec. 63 (2). This would, normally speaking, take place long before the year allowed under Sec. 34 had elapsed and the learned counsel for the Income Tax authorities was not able to show us how the Act would become

unworkable if this simple procedure of issuing a fresh notice were followed ordinarily.

I would therefore answer the questions as follows:

Question No: (1) in the affirmative;

Question No: (2) also in the affirmative;

Question No: (3) in its changed form is left undecided;

Question No: (4) is answered in the affirmative;

Question No: (5) is answered in the negative.

The assessee shall have the costs of this reference.

SKEMP, J.—I agree.

[IN THE BOMBAY HIGH COURT.]

BHOGILAL HARGOVINDAS PATEL

v.

COMMISSIONER OF INCOME TAX, BOMBAY.

SIR J. W. F. BEAUMONT, C. J., and BLACKWELL, J.

October 17, 1935.

LOSS—TRANSFER OF BUSINESS AFTER INCURRING LOSS—TRANSFEROR, WHETHER ENTITLED TO SET OFF LOSS AGAINST HIS OTHER INCOME—SCOPE OF SEC. 26 (2)—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 24, 26 (2).

The assessee who was carrying on certain business started in the beginning of the year 1933, the business of manufacturing and selling cigarettes. On the 1st September 1933 he transferred the cigarette business to a limited company, one of the terms of the sale being that the purchasing company was not to be liable for any losses incurred up to the date of sale. During the 8 months ending 1st September 1933, there was a loss of Rs. 47,488 in the cigarette business and the assessee claimed in his assessment for the previous year ending 31st December 1933 that he was entitled to deduct this loss from his other income:

Held, *that under the provisions of Sec. 26 (2) of the Indian Income Tax Act, it was the purchasing company that must be treated as having carried on the business for the whole of the year 1933, it was the person entitled to any set-off in respect of losses of that year, and the assessee was not therefore, entitled to set off the loss in question.*

BEAUMONT, C. J.—*Where the facts bring a case within Sec. 26 (2), Sec. 24 only applies to the assessment of the successor.*

Case stated by the Commissioner of Income Tax, Bombay, under Section 66 (2) of the Indian Income Tax Act, (XI of 1922). Civil Ref. No. 9 of 1935.

The facts and the question referred are stated in the judgment. The opinion of the Commissioner was as follows:—

" As Sec. 66 (2) of the Act requires me to give my opinion while submitting this statement of the Case, I beg to invite attention to Sec. 26 (2) of the Act. Under this section, when at the time of making an assessment under Section 23, it is found that the person carrying on a business has been succeeded by another in such capacity, the assessment has to be made on the successor "*as if he had been carrying on the business throughout the previous year* and as if he had received the whole of the profits for that year." Losses are not specifically mentioned but it is obvious that where there is a loss, the Income tax Officer cannot assess the successor "as if he had been carrying on the business throughout the previous year" without assigning the loss to him and not to his predecessor in the business. In this case, at the time of assessment, *viz.*, on 9th January, 1935, the Income tax Officer found that the business of manufacturing and selling cigarettes had been taken over by the Zenith Tobacco Co., Ltd., as from 1st September 1933. Hence he had to treat the business as having been carried on throughout the whole of the previous year, *viz.*, the calendar year 1933, by that company and the profit or loss for the whole of that year as having been received or sustained by it. As it is obvious that two different persons cannot be treated as having carried on the same business in the same period, the assessee had accordingly no *locus standi* regarding it as far as the Income tax Act was concerned. The assessee has claimed this loss under Sec. 24 of the Act but that section cannot apply to a loss which, as explained, the Income tax Department is expressly enjoined by Sec. 26 (2) to treat as another person's loss. For these reasons, I submit that the answer to the question should be in the affirmative."

Sir Jamshedji Kanga with *Messrs. Payne & Co.* for the Assessee.

Advocate-General with *Government Solicitor*, for the Crown.

BEAUMONT, C. J. :—This is a reference made by the Commissioner under section 66 (2) of the Indian Income tax Act. The question he raises is " Whether in view of the provisions of Sec.

26 (2) of the Income-tax Act, 1922, the Income-tax Officer acted correctly in not taking into account the loss in the cigarette business during the period 1st January to 31st August 1933, on the ground that at the time of assessment the assessee was not carrying on that business, having transferred it to the Zenith Tobacco Co. Ltd., which carried it on from 1st September, 1933."

The facts giving rise to the question are these: The year of assessment is the year 1934-35, and the previous year, as defined by Sec. 2 sub-section (11), is the year ending the 31st December, 1933. The assessee carried on certain business, and had income from other sources. Apart from his normal business he started at the beginning of the year 1933, the business of manufacturing and selling cigarettes, which he carried on under the name of "The Zenith Tobacco Company." As from the 1st September, 1933, the assessee transferred the cigarette business to a limited company called the Zenith Tobacco Company Limited. It is stated in the grounds of appeal to the Assistant Commissioner that the terms of the sale were that the purchasing company was not to be liable for any losses incurred at the date of the sale as between itself and the vendor. During the 8 months of the year 1933, during which the assessee was carrying on this tobacco business, he incurred a loss in respect on that business of Rs. 47,488; and the question is whether he is entitled to deduct that loss from his assessable income.

Section 24 of the Act provides that—"Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in Sec. 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year." This loss was incurred in respect of a business, which is one of the heads in Section 6, and under Sec. 24 taken by itself, the assessee would be entitled to set off any loss incurred by him under that head, of business against any income received by him under any other head, such as interest on securities or other sources; and apart from that, in so far as the assessee was dealing with profits under the head of business, he would be entitled to set off the loss incurred in respect of another business. So that I think, apart from Sec. 26, to which I will refer in a moment, the assessee would be entitled to deduct this loss from his assessable income.

Then comes Sec. 26, sub-Sec. (2) which is in these terms:—'Where at the time of making an assessment under Sec. 23, it is found that the person carrying on any business, profession or

vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year."

Now, at the time of making the assessment on the present assessee, it was found by the Income-tax Officer that the assessee had been carrying on this cigarette business and had been succeeded in such business by the purchasing company, and the section, therefore, provides that the assessment shall be made on the purchasing company, as if it had been carrying on the business throughout the previous year, that is during the whole of the year 1933, and as if it had received the whole profits of that year. Where the facts bring a case within Sec. 26 (2), Sec. 24 only applies, in my opinion, to the assessment of the successor.

It is argued on behalf of the assessee that Sec. 26 (2) does not apply unless there are profits. In fact there is no evidence in this case as to whether or not there were profits in this business for the whole of the year. We do not know what the position was during the last three months. There is no evidence that there were no profits made, and that therefore no assessment on the purchasing company was necessary; and in the absence of evidence to that effect, it seems to me that the Income tax Officer was quite right in saying that the section applied. I think the effect of the section is undoubtedly to make the successor to the business liable to the assessment for the whole of the year in question in respect of the business transferred. It is true that the section does not mention losses, but clearly those will have to be brought in for the whole of the year as against the profits of the year. It is not necessary to deal with the question whether Sec. 26, sub-Sec. (2), would apply if there were no profits in respect of the business transferred, and therefore no assessment was necessary on the successor, assuming that he had no other source of income. On the facts proved in this case, I think that the Income tax Officer was right in saying that it is the purchasing company which must be treated as carrying on the business for the whole of the year, and is, therefore, the person entitled to any set-off in respect of losses for that year, and that the present assessee is not entitled to set off any losses incurred in respect of this business against his assessable income in the year in question. So that the answer to the question will be in the affirmative.

Reference dismissed with costs. Costs to be taxed by the Taxing Master on the Original Side scale.

BLACKWELL, J.—I agree that the question should be answered in the affirmative. It seems to me that having regard to sub-Sec. (2) of Sec. 26, where a person carrying on any business has been succeeded in that business by another person, he is not entitled to claim the benefit of sub-Sec. (1) of Section 24 at all. In my view, it is not then open to him to contend that he, as an assessee, has sustained a loss of profits in the business which he has transferred, although there was a loss at the time of transfer.

It has been contended by Sir Jamshedji Kanga that, unless it is shown that the successor in the business had made profits, it would still be open to the predecessor in the business to claim that he had sustained a loss of profits on the ground that no assessment in such event could be made on the successor. Speaking for myself, I do not think that this is the true or proper construction to be placed upon sub-Sec. (2) of Section 26. In my view, that sub-section means that where a business has been transferred the Income tax Officers are entitled to call upon the successor to make a return. For the purpose of ascertaining whether the successor has made profits for the year, any losses previously sustained must be taken into account. It seems to me that it would be very strange if, though the successor is to be deemed to have been carrying on the business for the whole of the year and is entitled to take into account any losses made in the business before the transfer for the purpose of the return, nevertheless the predecessor in business, another assessee, should be entitled to bring into his return the losses made prior to the transfer. In my judgment, such an interpretation of the section is so unreasonable that unless one is compelled by the words used to place such an interpretation on it, the Court ought to decline to do so.

Accordingly, I think that the Income tax authorities came to the right conclusion, and that the question must be answered in the affirmative.

Question answered in the affirmative.

[IN THE RANGOON HIGH COURT.]

SECRETARY OF STATE FOR INDIA
v.
MA NYEIN ME and OTHERS.

MACKNEY, J.

February 19, 1937.

PRIORITY OF DEBTS—INCOME-TAX DEBT—PRIORITY OVER OTHER UNSECURED DEBTS—POWERS OF COLLECTOR—INDIAN INCOME TAX ACT (XI OF 1922), SECTION 46 (2)—LOWER BURMA LAND AND REVENUE ACT, 1876, SECTION 45.

The Crown has priority over unsecured creditors in respect of arrears of income-tax due from the debtor. The fact that a creditor had attached the assessee's property does not give him any preferential right over the Crown.

Though a Collector acting under Sec. 46 (2) of the Indian Income Tax Act can exercise all the powers of a Civil Court for recovering arrears of income tax, he is still not a Civil Court and he cannot apply for rateable distribution under Section 73 of the Civil Procedure Code.

Cases referred to:

BRITISH COAL CORPORATION *v.* REGEM [1935] (1935 A. C. 500; 70 L.J.P.C. 58).

COMMISSIONER OF TAXATION *v.* PALMER [1907] (1907 A.C. 179; 76 L.J.P.C. 41).

JUDAH *v.* SECRETARY OF STATE [1886] (12 Cal. 445).

PENINSULAR AND ORIENTAL STEAM NAVIGATION CO. *v.* SECRETARY OF STATE [1868] (5 Bom. H. C. App. 1).

SECRETARY OF STATE *v.* BOMBAY LANDING & SHIPPING CO. [1868] (5 H.C.O.C. 23).

SONIRAM RAMESHWAR *v.* MARY PINTO [1934] (11 Rang. 467; A.I.R. 1934 Rang. 8; 1934 I.T.R. 58; 147 I.C. 1014).

Application to revise the order of the District Court of Thaton in Civil Execution Case No. 5 of 1936. Civil Revision No. 323 of 1936.

Tun Byu for Applicant.
K. C. Sanyal for *A. A. Darwood* for Respondents 1 to 4.
P. K. Basu for Respondent 5.
Respondent 6 in person.

MACKNEY, J.—This is an application to review the order of the learned District Judge of Thaton in Civil Execution Case No. 5 of 1936, wherein he made a rateable distribution of certain assets at the disposal of the Court between certain parties, but rejected the claim made by the Collector of Thaton on behalf of the Secretary of State for India in Council to the whole or part of the said assets. In order to reduce the complexity of the case it will be necessary to set out its history and to construe the legal position of the parties. In Civil Execution Case No. 152 of the Township Court of Thaton, respondent 5, A.R.N.A.R. Karuppan Chettyar, sought to execute his decree against one Ma Fati. In pursuance thereof, certain moveable property said to belong to Ma Fati was attached, and the same apparently came into the custody of the Court. On 18th May 1935, the Collector of Thaton received a certificate under Section 46 (2), Income-tax Act, 1922, from the Income-tax Officer, Thaton, certifying that a sum of money was due from Ma Fati in respect of arrears of income-tax and requesting the Collector to take steps to recover the same as if it were an arrear of land revenue. The Township Officer, Thaton, was directed to take steps to recover the amount.

In due course the Township Officer issued a warrant of attachment of the property which had already been attached by the Township Court and was in its custody. By some mistake the Township Officer obtained possession of the property and sold it. He then reported his proceedings to the Collector of Thaton. A third party put in claim for the property, and this claim was heard in appeal by the Commissioner of the Tenasserim Division. The Commissioner came to the conclusion that the sale of the property by the Township Officer of Thaton was invalid and must be set aside. The Deputy Commissioner was directed to apply to the Income-tax Department, to whom apparently the proceeds of the sale had already been paid, for refund of the sale proceeds. The money was then to be made over to the Township Court, Thaton, which had attached the property. The appellant was directed to address her claim to the sale proceeds to that Court. The claim of this person does now concern us. The Deputy Commissioner, by a letter dated 6th February 1936, forwarded the proceeds of the sale to the Township Officer, and at the same time lodged a claim on behalf of the Income-tax Department to the whole or a portion of the amount in rateable distribution among the several creditors. Meanwhile in Civil Execution Case No. 1 of 1936 of the Sub-divisional Court of Thaton, respondent 6,

Messrs. the Bombay Burma Electric Company, by one of their partners, R. A. Nagari, sought to execute their decree against Ma Fati, and in pursuance thereof the said sale proceeds were attached whilst in the custody of the Treasury Officer of Thaton and before they had been forwarded to the Township Court. In Civil Execution Case No. 5 of 1936 of the District Court of Thaton, the first four respondents, Ma Nyein Me, Ma Kyu Yin, Ah Ma Bu and Daw Thit, had also attached the sale assets in the hands of the Treasury Officer in execution of their decree against Ma Fati. The proceedings came before the District Judge under Section 73, Civil Procedure Code, in order to determine the rights to the various claimants.

Now, it appears to me that the intention and result of the order of the Commissioner of Tenasserim Division was to restore as near as might be the position at the time the Township Officer of Thaton had issued his attachment of the property of Ma Fati in the custody of the Township Court. Being unable to restore the actual property, the proceeds of the sale thereof were restored, and it seems to me that they must be regarded as being in the same position as the original property, that is to say, they were in the custody of the Township Court in virtue of the attachment that had been made in Civil Execution Case No. 152 of 1935; so also the sale proceeds must be regarded as being held at the disposal of the Township Officer of Thaton by virtue of the attachment made by him. Under O. 21, R. 52, Civil P. C., the Court had to decide the question of priority arising between the various decree-holders and the Collector of Thaton, in whose behalf the Township Officer, Thaton, was acting. Much time was occupied at the hearing of this petition by the argument on behalf of the respondents that there was no effective application on behalf of the Collector of Thaton before the Court to which it could pay attention. Section 46, sub-sec. (2) of the Income-tax Act, is as follows:

"The Income-tax Officer may forward to the Collector a certificate under his signature specifying the amount of arrears due from an assessee, and the Collector, on receipt of such certificate shall proceed to recover from such assessee the amount specified therein as if it were an arrear of land revenue. Provided that without prejudice to any other powers of the Collector in this behalf, he shall for the purpose of recovering the said amount have in respect of the attachment and sale of debts due to the assessee the powers which under the Code of Civil Procedure 1908, a Civil Court has in respect of the attachment and sale of debts due to

a judgment-debtor for the purpose of the recovery of an amount due under a decree."

Now, Sec. 45, Lower Burma Land and Revenue Act, 1876, is as follows:

"An arrear may be realized as if it were the amount of a decree for money passed against the defaulter in favour of any Revenue Officer whom the Local Government may from time to time appoint in this behalf by name or as holding any office. Proceedings with a view to the realization of such arrears may be instituted by such officer before any other revenue Officer whom the Local Government may from time to time appoint by name or as holding any office and, except in so far as the Local Government may otherwise by rule direct, such other officer may exercise all the powers conferred on, and shall conform to all rules of procedure prescribed for, a Court executing a decree by the Code of Civil Procedure . . ."

I think, taking these two provisions of the law together, that what is meant is that on receipt of the certificate of the Income-tax Officer, the Collector, in proceeding to realize the arrears, exercises all the powers conferred on, and shall conform to all rules of procedure prescribed for, a Court executing a decree by the Code of Civil Procedure, and that it is not intended that the Collector should regard himself as a Revenue Officer in whose favour a decree for money has been passed against the defaulter and be obliged to institute proceedings for realization before another Revenue Officer. This, I think, is made clear by the wording of the Proviso to Sec. 46, sub-s. (2), Income-tax Act, where it is definitely stated that in certain circumstances and in regard to certain procedure the Collector shall have certain powers of civil Court. It was in pursuance of these powers that the warrant of attachment of the property of Ma Fati in the custody of the Township Court of Thaton was issued. It has been argued that the letter of the Collector dated 6th February 1936, in which he forwarded the sale proceeds to the Township Court and laid claim thereto was not such a compliance with the procedure laid down by the Code of Civil Procedure as was required. It may be that there is considerable force in this contention; although, in the confusion which had overcome the proceedings, it is not hard to understand how the Collector came to act in this way, and it is possible that in the peculiar circumstances of the case, the letter of the Collector might be construed as amounting to an order to the Township Court under O. 21, R. 52, to hold the sale proceeds

subject to the further orders of the Collector. However it is not necessary to consider this point, because, as I have already pointed out, it is clear that the prohibitory order or attachment previously issued by the Township Officer of Thaton was still effective in regard to these assets. There can be no doubt that the previous attachment ordered by the Township Court of Thaton was still effective, and that has never been doubted. The same reasoning applies to the previous attachment by the Township Officer of Thaton. That being so, it is clear that the Collector must be deemed to have adopted the proper procedure in regard to the recovery of the income-tax arrears.

As already stated, the Rule applicable was that set out in O. 21, R. 52. The claim of the Collector certainly cannot be deemed to fall under Sec. 73, Civil P. C. Although the Collector is empowered to exercise all the powers conferred on a Court executing a decree by the Code of Civil Procedure, he does not thereby become a civil court. The provisions of Sec. 73, Civil P. C., can only be applied to civil Courts. There can be no rateable distribution between such decree-holders as come within the scope of Sec. 73, Civil P. C., and the Collector consequently, unless he can have recourse to some other rule of law, must inevitably fail in his claim in such circumstances as the present. Such a rule of law is that whereby the Crown has priority over unsecured creditors in the payment of debts. This is a well-known principle of law applied both in England and in India. In virtue of that rule and in such circumstances as the present, the Court holding the assets was bound to recognise the prior claim of the Crown and to hand over the whole of the assets in question to the Collector of Thaton. It has been argued at great length before us that this doctrine of priority of Crown debts is not a rule of law in India. But if that were so, the Crown would have no recourse in such a case as the present, and it surely would be a most remarkable omission on the part of the Legislature of this state if affairs had passed unnoticed. The rule of law referred to is universally recognized in India, and that being so, the powers given to the Collector on behalf of the Crown under the Income-tax Act and the Lower Burma Land and Revenue Act are sufficient to accomplish the purpose in view. In *Soniram Rameshwar* v. *Mary Pinto* the leading cases on the question of the Crown's right to priority were reviewed and discussed, and the conclusion, in the words of LEACH, J. is:

"With regard to unsecured creditors I hold that the Secretary

of State for India in Council representing the Crown is entitled to priority in payment."

The learned Judge went even further and added:

" Where there are funds in Court out of which payment can be made, the Court can order payment without prior attachment."

The *locus classicus* for consideration for this question is in *Secretary of State* v. *Bombay Landing and Shipping Co.* The state of the law on the subject is fully set out in this judgment, and towards the conclusion thereof it is stated:

" The East India Company, at all events down to the passing of the Act 3 and 4 Wm. IV. c. 85, were beneficially interested in the revenues of India, and, even after the passing of that Statute, and down to the close of their career as a governing power, in 1858, continued so interested to the extent of their dividends on their capital stock; yet we have shown that, with respect to many items of their revenue, they were entitled to the same advantages of suit as the Crown. The Secretary of State in Council has no interest whatever in the revenue of India. Whatever rights the Crown had to any portion of Indian revenue before 1858, it still has. Further, Sec. 2 of the Statute of that year (21 and 22 Vict. c. 106) vested in the Crown all the territorial and other revenues of or arising in India, and directed that all of those revenues should be received not only for, but in the name of, Her Majesty."

Although most of the enactments considered by the learned Judges were enactments relating to the Supreme Courts at Fort William and Madras, the Record's Court at Bombay, and the Court of Judicature at Prince of Wales Island, yet it is obvious that the principles of law deduced cannot be limited to effect within only the jurisdictions of those Courts. There can be no distinction between revenue collected outside those jurisdictions and revenue collected within them, and the same rules of law must apply to both under the present regime, inaugurated by the Imperial Statute of 1858 which, in this respect, has been in no way altered by subsequent enactments. This decision has been followed by all the High Courts in India, and decisions to that effect are so well known that I consider it unneccessary to quote them in detail. In *Commissioners of Taxation for the State of New South Wales* v. *Palmer*, the rule was applied in New South Wales. The argument as to the limitation of the prerogative of the Crown which was urged before us is one that was brought to the notice of the learned Judges who decided the case in *Judah* v. *Secy. of*

State. The following passage from the judgment is pertinent. At p. 452 they say:

"Secondly, it was urged that whether, apart from the specific enactment, this would be a Crown-debt or not, the effect of Section 65 of the Act for the Better Government of India is to place it on a different footing. It was contended that the effect of that section, read in connection with some earlier sections, is that in matters of this nature, neither the Secretary of State nor any higher authority represented by the Secretary of State shall, in any respect, stand in a better position than the East India Company would have stood in if the same events had occurred during the time of its Government.

I do not think there is any such intention to be gathered from the Act. The section first empowers the Secretary of State to sue and be sued: so far it deals only with the manner in which suits are to be brought, and has nothing to do with substantive rights. The latter part of the section says nothing as to what rights may be acquired either by the Secretary of State, or by the Crown through the Secretary of State, nor as to the nature or character of rights so acquired. It leaves that to be governed by the ordinary principles of law. But with regard to liabilities which may be enforced against the Secretary of State there are express words, and the reason of that, as explained in the judgment in *Peninsular & Oriental Steam Navigation Co.* v. *Secretary of State* would seem to be that the East India Company not being a Sovereign body, might have been made liable by suit in cases in which such a remedy would not, without special enactment, be available either against the Crown or against any servant of the Crown as such; and that it was intended to give the same remedies, in some cases at least against the revenues of India by suit against the Secretary of State which were formerly admissible against the East India Company. But whether this be the true view or not, it has nothing to do with the nature of a Crown-debt."

There can be no question that the same rule of law as has been applied in India is applicable in Burma also. It cannot be contended that the Kings of Burma, in the matter of the collection of revenue, exercised a lesser prerogative than that of the Crown in England. Their authority in such matter in fact extended even to the selling of revenue, defaulters of Rs. 30 and upwards into slavery: *see* Harvey's History of Burma," p. 359. In Act No. 32 of 1860 (an Act for imposing duties on profits arising from property,

professions, trades and offices), which is the first of the Income-tax Acts of India, in S. 185 it is said:

"The claim of the Government for all sums payable for the said duties shall have priority over all private claims, arising after the said duties accrued due, upon any immoveable property attached, or upon any moveable property distrained upon under this Act. Provided that if the property attached by itself forms the subject of the assessment in respect of which the attachment shall have issued the claim of the Government for the arrears due on the said assessment shall have priority over all private claims."

Section 186 reads:

"No goods or chattles shall be liable to be taken by virtue of any execution or other process, warrant, or authority, or by virtue of any assignment or on any pretence whatever, unless the person at whose suit the execution or seizure shall be sued out or made, or to whom such assignment shall be made, shall, before the sale or removal of such goods and chattles, pay or cause to be paid to the proper officer all arrears of the said duties which shall be due by the judgment-debtor or assignors at the time of seizing such goods or chattles or which shall be payable for the year in which such seizure shall be made, provided that the said duties shall not be claimed under this section for more than one year."

Section 188 is as follows:

"The claim of the Government for all sums payable for the said duties shall have priority over all claims in administering the assets of any deceased person by his representative, or of any bankrupt or insolvent by his assignee, provided that the said duties shall not be claimed under this section for more than one year."

Those provisions were not re-enacted in the present Income-tax Act. It would appear that the provisions set out in Sec. 46, sub-Sec. (2) of that Act, already quoted, were considered sufficient, in view of the well-known principle of the priority of Crown-debts. It is useful in this connection to revert to the case in *Secretary of State* v. *Bombay Landing & Shipping Co.* where the learned Judges referred to these sections of Act No. 32 of 1860. At the foot of p. 30 and on p. 31 they say:

"The reservation of prerogative privileges to the Commissioners in their litigation and the reservation of the Crown's right to proceed in the Exchequer, no doubt, afford an argument in support of the legal necessity for such provisions; but such an argument is never, when it stands alone, a very strong one and does

not relieve us from the duty of inquiring into the state of the law previous to such enactments. Legislation of that kind is often merely declaratory, and resorted to *pro majori cautela*, and for the purpose of clearly notifying to the public what the law is......... What has been said with respect to those statutes is in great part applicable to the provision in Ss. 185 and 188 of Act 32 of 1860. A clear declaration of the priority of income-tax over private claims may have been considered especially necessary for the Mofussil where the extent to which English Law should be applied is much less clearly defined than in the Presidency towns. There are, moreover, certain special provisions which are variations from the English law, as to the priority of the claim of the Crown, introduced into both of those sections."

There are, of course, various Acts of the Indian Legislature which do expressly set out the priority of Crown-debts in circumstances arising under those Acts, but such express enactments cannot be deemed to derogate from the general right of priority which the Crown has. What these enactments do is merely to make clear that particular application of the rule. Express words or necessary implication is required to affect the prerogative of the Crown in a municipal statute: *see British Coal Corporation* v. *Regem*. The learned counsel for the respondent has not been able to indicate to us any authority in India which takes a contrary view from that set out in the decisions cited above. In the present case, the decree-holders concerned were in no better position than the Crown; their debts were on an equal footing, and in these circumstances the right of the Crown must prevail. It is not contended that an attachment confers any title.

It would not appear that the learned District Judge fully understood the real facts of the matter before him. Nor did he understand the application of the principle of the priority of crown debts. Doubtless it was stated to him in too blunt a fashion, else he would not have been aroused to such depths of emotion as he apparently was by what he conceived to be an unprecedented attack on the rights of the subject. It appears to me that owing to this misapprehension, the learned District Judge in rateably distributing the assets among the respondents acted illegally and with material irregularity in the exercise of his jurisdiction. I would therefore, allow this application, set aside the order of the District Court and direct that the sum of Rs. 466, which was the subject of the order, shall be refunded to the District Court by the parties who have drawn it and shall be handed over to the Collector of

Thaton for disposal in accordance with law. The respondents shall pay the costs of this application: advocate's fee ten gold mohurs.

MYA BU, J.—I agree.

Application allowed.

[IN THE LAHORE HIGH COURT.]

KUNWAR KARTAR SINGH

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

COLDSTREAM and DIN MOHAMMAD, JJ.

June 4, 1937.

IMPARTIBLE ESTATES—JAGHIRS OF PUNJAB—DESCENT OF JAGHIR APPROVED BY GOVERNMENT ON CONDITION OF SUCCESSOR PAYING FIXED ALLOWANCE TO JUNIOR MEMBER 'OUT OF THE ASSIGNMENT'—ALLOWANCE RECEIVED BY JUNIOR MEMBER, WHETHER EXEMPT—'AGRICULTURAL INCOME'—'SUM RECEIVED AS MEMBER OF HINDU UNDIVIDED FAMILY'—INDIAN INCOME TAX ACT (XI of 1922), SECS. 4 (3) (viii), 14 (1)—PUNJAB DESCENT OF JAGHIRS ACT, 1900, SEC. 8-A.

The assessee was the younger of the two sons of a Jagirdar the descent of whose jagir was regulated by the Punjab Descent of Jaghirs Act, 1900, since incorporated in the Punjab Laws Act. The rule of descent declared under the Act to prevail in this family involved the devolution of the assignment of land revenue to a single person only as impartible property and the Government was empowered under the Act to declare that the devolution shall be subject to the condition that the successor to the assignment shall be approved and accepted as such by the Government, and that the successor so approved shall if so required by the Government, make such provision out of the assignment as the Government may consider suitable for the maintenance of the widow or widows or other members of the family of the last or any previous holder of the assignment. In exercise of this power the Government had issued two notifications and declared that the rule of descent shall be primogeniture and that it shall be subject to both the conditions mentioned above. On the death of the assessee's father, the assessee's elder brother was approved as successor and he was required to pay Rs. 6,000 per annum (an amount which had been agreed

upon) to the assessee by way of maintenance 'out of the assignment'. The assessee claimed that the allowance paid to him was exempt from income tax, on the ground that it was agricultural income and also because it was a sum received as a member of a Hindu undivided family:

Held, (*i*) *that the words 'out of the assignment' contained in the Government order made it clear that the intention of the Government was that the assignment as such should pass to the other members, and the allowance received by the assessee was therefore agricultural income and exempt from income tax under Sec. 4 (3) (viii); (ii) the allowance was not however, a sum received by the assessee as a member of a Hindu undivided family within Sec. 14 (1) of the Act.*

In order that a sum received may be exempt under Sec. 14 (1) it should be a sum received from the joint income of the family and not otherwise.

Cases referred to:

COLLECTOR OF GORAKHPUR *v.* RAM SUNDAR MAL [1934] (56 All. 468; 61 I.A. 286; 150 I. C. 542; A. I. R. 1934 P. C. 157).

COMMISSIONER OF INCOME TAX, BENGAL *v.* SHAW WALLACE & Co. [1932] (6 I.T.C. 178; 36 C.W.N. 653; 24 Bom. L.R. 1033; 136 I. C. 742; 59 I. A. 206; A. I. R. 1932 P. C. 138) **P.C.**

COMMISSIONER OF INCOME TAX, BIHAR & ORISSA *v.* MAHARANI LAKSHMIBATI SAHEBA [1935] (14 Pat. 313; 8 I.T.C. 5; 1935 I. T. R. 49).

COMMISSIONER OF INCOME TAX, BIHAR & ORISSA *v.* MAHARAJ KUMAR VISHWESWAR SINGH [1936] (14 Pat. 785; 156 I. C. 116; 1935 I. T. R 216; 8 I. T. C. 295).

COMMISSIONER OF INCOME TAX, MADRAS *v.* NARAYANA GAJAPATI GARU [1934] (57 M. 1023; 7 I. T. C. 304; 1934 I.T.R. 208; A. I. R. 1934 Mad. 608).

CONVILLE, L.H.G. *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1935] (8 I. T. C. 399; 1935 I. T. R. 404).

DIWAN KISHAN KISHORE *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1933] (14 Lah. 255; 141 I. C. 415; 1933 I. T. R. 143; A. I. R. 1933 Lah. 284).

GOPAL SARAN NARAIN SINGH *v.* COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA [1935] (14 Pat. 552; 8 I. T. C. 340; 1935 I. T. R. 237).

MAHARAJ KUMAR OF VIZIANAGARAM, IN RE [1934] (56 All. 1009; 1934 I. T. R. 186).

MOOLJI SICKA & CO., IN RE [1935] (1935 I.T.R. 123; 8 I.T.C. 147; 40 C. W. N. 517).

LAKSHMI NARASAYAMMA GARU *v.* COMMISSIONER OF INCOME-TAX, MADRAS [1929] (52 M. 827; 119 I. C. 387; A. I. R. 1929 Mad. 598; 57 M.L.J. 36).

SALTANAT BEGUM, IN RE [1933] (7 I.T.C. 111; 1933 I.T.R. 379; A.I.R. 1933 Oudh 475; 146 I.C. 651).

SHIBA PRASAD SINGH *v.* PRAYAG KUMARI DEBI [1932] (59 Cal. 1399).

SUNDRABAI SAHEBA *v.* COMMISSIONER OF INCOME-TAX, BOMBAY [1933] (5 I.T.C. 493).

Case stated by the Commissioner of Income-tax, Punjab N. W. F. P., and Delhi under Sec. 66 (2) of the Indian Income Tax Act in the matter of the assessment of Kunwar Kartar Singh of Ambala for the year 1934-35.

Mehr Chand Mahajan and *Kirpa Ram Bajaj* for the Assessee.

J. N. Aggarwal and *S. M. Sikri* for the Commissioner of Income-tax.

JUDGMENT.

DIN MOHAMMAD, J.—This order will dispose of Civil Miscellaneous No. 530 of 1936 which is an application under Sec. 66 (3) of the Income-tax Act for the issue of a mandamus to the Commissioner of Income-tax, as well as Civil Reference No. 9 of 1937, which is a statement of the case drawn up by the Commissioner under Sec. 66 (2) in relation to the same assessment.

The assessee, Kunwar Kartar Singh is the younger of the two sons of *Sardar Bahadur Sardar* Jiwan Singh of Shahzadpur, the elder being Colonel Ram Singh. *Sardar Bahadur Sardar* Jiwan Singh was a *Jagirdar*, the descent of whose Jagir was regulated by the Descent of Jagirs Act, 1900 (since incorporated in the Punjab Laws Act, 1872). His estate was impartible. Under the provisions of the above mentioned Act, on the death of *Sardar Bahadur Sardar* Jiwan Singh in 1927, the Jagir devolved on the elder son to the exclusion of the younger son, but the condition imposed under the Act on this devolution was that the holder of the Jagir should pay Rs. 6,000 per annum out of the jagir to his younger brother for maintenance. In the assessment for 1934-35, the Income-tax Officer, presumably for the first time since 1927, included this sum in the total assessable income of the assessee. To this the assessee demurred on two grounds:—

(1) that as the allowance was made out of the assignment it was exempt from tax under Sec. 4 (3) (viii) of the Income-tax Act in the same manner as the original assignment was exempt; and

(2) that he receives this allowance as a member of a Hindu undivided family, and such receipts were exempt under Sec. 14 (1) of the Act.

The Income-tax Officer overruled both these contentions. On the first point he held that as the assessee received the allowance from his brother and not direct from the revenue authorities, and as the 'proximate relation' and not the 'ultimate source' was the determining factor in such matter, the allowance lost its original character in the hands of the assessee and was, consequently, not exempt from taxation. On the second point, he observed that the term 'Hindu undivided family' as used in the Act carried a restricted meaning and as the assessee was not a co-parcener in the impartible estate, the allowance that he received for his maintenance was not covered by Sec. 14 (1).

The assessee appealed to the Assistant Commissioner against the order of the Income-tax Officer, but that officer, too, upheld the order. The assessee then applied to the Commissioner under Sec. 66 (2) but the Commissioner refused to make a reference to this Court. Thereupon, the assessee presented an application to this Court under Sec. 66 (3) and asked for the issue of a mandamus to the Commissioner on the following question:

"Whether the maintenance allowance of Rs. 6,000 which the assessee receives out of the Jagir income from his brother, Colonel Ram Singh, who, according to law and custom of primogeniture has inherited the impartible estate of the family, is not exempt under Secs. 2 (1) and 14 (1) of the Income-tax Act."

This application was laid before a Division Bench of this Court for preliminary hearing on the 16th October 1936, and the Bench admitted it and issued a notice to the Commissioner. On receipt of this notice, the Commissioner intimated to this Court by a letter dated the 12th November, that the matter might be adjourned as he was making a reference under Sec. 66 (2). The hearing of the application under Section 66 (3) was accordingly adjourned and on the 26th January 1937, the Commissioner drew up a statement of the case, propounding the following two questions for our decision:

"(1) Has the assessee established that the sum of Rs. 6,000 paid to him under the agreement of 12th May 1927, by his elder brother, was received by him as a member of the Hindu undivided family constituted of him and that brother (with their descendants) and, therefore exempt under Section 14 (1)?

(2) If not, has the assessee established (by evidence such that in law the contrary could not be found) that the sum of Rs. 6,000 paid to him under the agreement of 12th May 1927, by his brother, was an assignment to him of land revenues, by and in privity with Government, and not a fixed sum of maintenance allowance by and under the said agreement and, therefore, exempt under Section 4 (3) (viii)? "

Before I proceed further it will be necessary to settle what question really arises in the case and in what form, especially as the assessee takes exception to the form of the question propounded by the Commissioner and invites a decision first on his own application under Sec. 66 (3).

It would appear from the questions reproduced above that the Commissioner has founded both the questions propounded by him on agreement said to have been executed on the 12th May 1927. This was really an application made to the Deputy Commissioner by *Sardar* Ram Singh asking him to fix the allowance of his younger brother at Rs. 6,000 which the latter had agreed to receive in lieu of his relinquishing all claim to the moveable and immoveable property, etc., left by his deceased father. *Sardar* Kartar Singh also expressed his consent to this arrangement. Ultimately, the allowance was fixed at that figure, although the usual practice was to fix it at 10 per cent. as indicated in the application alluded to above. In spite of this, however, I am disposed to think, that it is wrong to assume that the allowance paid to the assessee was based on any agreement arrived at between the two brothers. At pages 13-15 of the statement of the case all the relevant sections of the Descent of Jagirs Act and the Government Notifications have been set out and their perusal would show that not only the allowing of the maintenance depended on the will of the Government but even the sum was to be fixed by it. The rule of descent declared under the Act to prevail in this family 'involved the devolution of the assignment of land revenue' to a single person only as impartible property and the Government was empowered under the Act further to declare that the devolution shall be subject to the condition that the successor to the assignment shall be approved and accepted as such by the Government and that the successor so approved and accepted shall, if so required by the Government, make such provision out of the assignment as the Government may consider suitable for the maintenance of the widow or widows or other members of the family of the last or any previous holder of the assignment.

In the exercise of this power, the Punjab Government in 1904 issued two notifications Nos: 98 and 99 (printed at page 15) and declared that the rule of descent shall be primogeniture and that it shall be subject to both the conditions mentioned above. On the death of *Sardar* Jiwan Singh, Colonel Ram Singh was approved as his successor under the first condition and he was further required to pay Rs. 6,000 under the second condition. The sum no doubt had been fixed by consent of the parties but the final word lay with the Government. It was open to the Government not to have fixed the maintenance at that figure—it could even leave the younger son quite unprovided for by making no such requirement as is contemplated in Section 8-A (b). It is misleading, therefore, to say that the assessee was paid the sum in question under that agreement.

The question propounded by the assessee also errs in this respect that it seeks to place the onus on the Department to prove that the allowance is liable to tax. To me, however, the true legal position appears to be this: the assessee receives Rs. 6,000 *per annum* and normally this income would be assessable. If the assessee claims exemption, he must establish under what provision of the Income Tax Act it is so exempt.

In view of what has been stated above, I consider that the real question arising in this case is whether the sum of Rs. 6,000 received by the assessee every year under the order of the Governor-in-Council from his elder brother by way of maintenance out of the assignment is exempt under Section 4 (3) (viii) or Section 14 (1) of the Income-tax Act. Had the Commissioner not drawn up the statement of the case *suo motu* after having refused to do it at once, it would have been necessary for us to issue a *mandamus* to the Commissioner on this question, but now that the Commissioner has submitted a full statement of the case, it would be useless to call upon the Commissioner to observe that formality once more. As has been held in several cases it is open to this Court to determine the real question at issue and to answer it. Reference in this connection may be made to *Commissioner of Income-tax, Bengal* v. *Shaw Wallace & Co.*, in which this course was approved. I would, accordingly proceed to decide the case on the lines indicated above.

There are two matters that deserve consideration: (1) Whether this sum of Rs. 6,000 is agricultural income and (2) whether this sum is being received by the assessee as a member of a Hindu

undivided family. If either of these questions is replied in favour of the assessee, this assessment cannot stand.

I first take up the question whether the allowance is agricultural income. The assessee contends that as he receives the allowance under the order of the Governor-in-Council out of the assignment, it is agricultural income and thus exempt from tax. It is common ground that the assignment as such is exempt and the only question that falls to be determined, therefore, is whether the allowance retains its original character in the hands of the assessee or loses it in transmission. No direct authority on this point having been cited to us, I am compelled to formulate my own conclusion from the facts proved in the case. After considering all the circumstances of the case, I am inclined to hold that the allowance is a part of the assignment and as such cannot be taxed. As explained above, the provision of this maintenance allowance is to be made out of the assignment and the present holder of the assignment is bound under the orders of the Government to pay to the assessee 'out of the assignment'. It is as if the holder is under the terms of his own grant required to cut off this slice and pass it on to the assessee. The assignment being impartible cannot be divided among the various claimants. The rule of descent being primogeniture, the entire block must go to the first born. But the Act achieves the object of apportioning a part of the assignment to the other members of the last or any previous holder of the assignment by imposing a condition on the present holder to make provision 'out of the assignment' for other members of the family. The insertion of the words 'out of the assignment' leaves no doubt in my mind that what is intended by the Government is that the assignment as such should pass to the other members, so that if default is made by the holder, arrangement could be made to divert it to the claimants at the very source.

The Commissioner has referred to certain decided cases in support of his action but in my view none of them is relevant. In *Saltanat Bègum, In re*, the assessee who was a widow of a Taluqdar had in a compromise effected in the course of a litigation given up her claim to the estate and accepted in lieu thereof a sum of Rs. 4,000 per mensem as a maintenance allowance. She claimed exemption for this allowance on the ground that it came out of the agricultural income. It was held, and rightly so, that it was not agricultural income in her hands. In *Lakshminarasayyamma* v. *Commissioner of Income tax, Madras*, a life-estate

was given to a widow who was directed to give Rs. 600 per mensem to the daughter of the last male-holder. The learned Judges who decided the case remarked that the mere fact that a certain pecuniary legacy bequeathed by a zamindar had to be paid by his executor out of agricultural income did not make the legacy itself "agricultural income" within Sec. 2 (1). In *Sundarabai Saheba* v. *Commissioner of Income-tax, Bombay*, it was observed that a monthly maintenance allowance under a decree of Court not specifying whether the allowance was payable out of the corpus or the income of her husband's estate consisting *inter alia* of agricultural lands was assessable to tax. In *Maharajkumar Gopalsaran Narain Singh* v. *Commissioner of Income Tax, Bihar & Orissa*, the assessee had transferred his estate to another person in consideration of, among other things, the payment to him for life of an annuity of Rs. 2,40,000 the annuity having been made a charge on the lands transferred by a separate deed. Their Lordships of the Privy Council remarked that the annuity was not agricultural income but money payable under a contract imposing a personal liability, the discharge of which was secured by a charge on land. In *Diwan Kishan Kishore* v. *Commissioner of Income Tax, Punjab*, an allowance made to a younger brother was held to be his income not that of the elder brother. The principle of law enunciated in this case, to my mind, goes against the contention put forward on behalf of the Commissioner. In the same manner as the allowance could not be treated as the income of the elder brother, the assignment in this case cannot be treated as the income of Colonel Ram Singh. This being so, it cannot be assessed, as the younger brother receives that slice out of the assignment itself, which to this extent does not go to his elder brother.

The assessee places his reliance on *Major L. H. G. Conville* v. *Commissioner of Income Tax, Punjab & N.W.F.P.* and though that case proceeds on different facts, certain remarks made therein may be of some help to him. It was observed that there the agricultural income did not lose its original character merely because those who were entitled to receive it did not receive it in its crude form.

I would hold, therefore, that the allowance is a part of the agricultural income and as such immune from tax.

On the second question, whether the assessee receives the allowance as a member of a Hindu undivided family, my opinion is against him. The assessee relies in support of his contention on *Shiba Prasad Singh* v. *Prayag Kumari Debi, Collector of Gorakh-*

pur v. *Ram Sundar Mal*, *Commissioner of Income Tax, Bihar & Orissa* v. *Maharaja Kumar Visweshwar Singh*, *Maharaja Kumar of Vizianagaram, In re* and *Commissioner of Income-tax, Madras* v. *Narayana Gajapati* while *Moolji Sicka, In re* and *Commissioner of Income Tax, Bihar & Orissa* v. *Maharani Lakshmibati Sahiba* have been cited on behalf of the Commissioner.

In *Shiba Prasad Singh* v. *Prayag Kumari Debi* their Lordships of the Privy Council held that the right of survivorship is not inconsistent with a custom of impartibility and it applies to the devolution of an impartible estate in a Mitakshara joint family. In order to establish that the family has ceased to be joint, it is necessary to prove an intention, express or implied, on the part of the junior members to renounce their right of succession and it is not sufficient to show a separation in food and worship merely.

In *Collector of Gorakhpur* v. *Ram Sundar Mal* the claim of a Hindu to succeed by survivorship to an ancestral impartible estate was in issue. The family admittedly has been joint. It appeared, however, that for a long period there had been a complete separation in worship, food and local intercourse between the claimant's branch of the family and that of the deceased holder. In was held by their Lordships of the Privy Council that there was not to be implied from the circumstances stated above a renunciation of the right to succeed so as to terminate the joint status for the purposes of that right. This authority was based on *Shiba Prasad Singh* v. *Prayag Kumari Debi*.

In *Commissioner of Income-tax, Bihar & Orissa* v. *Maharaja Kumar Visweswar Singh*, the assessment was cancelled as it was held that in the case of an impartible Raj the fact that the holder for the time being is exclusively entitled to the estate was not inconsistent with other members of the family being joint with him. The case reported in I.L.R. 56 All. 468 (*Collector of Gorakhpur* v. *Ram Sundar Mal*) was followed.

In *Maharajkumar of Vizianagram, In re*, it was observed that the assessee as a member of the Vizianagram family having acquired a right in the ancestral property by birth could not but be considered to be a member of a Hindu undivided family. He would cease to be a member of such an undivided family only if he expressly or impliedly renounced his right of succession to the estate. This decision was again based on *Shiba Prasad Singh* v. *Prayag Kumari Debi*.

In *Commissioner of Income Tax, Madras* v. *Zamindar of Chemudu* (*Narayana Gajapathi Garu*) a sum received as maintenance by an assessee as the brother of the last holder of an ancestral impartible estate entitled under the law to receive maintenance out of such estate was considered to be a sum received by him as a member of a Hindu undivided family. It was remarked that the right to maintenance which the son of a *zemindar* still possessed was not the creature of custom but it was an incident to the ordinary joint family property which had been left untouched by custom despite its encroachment on the other incidents. The Commissioner had in that case urged that as there was no co-parcenary, there was no Hindu undivided family. This contention was repelled. It may be observed here that a contrary proposition was laid down in *Moolji Sicka, In re* (3 I.T.R. 123) which is otherwise referred to in the statement of the Commissioner as *Moolji's case*. A Division Bench of the Calcutta High Court has held that where in the sections of the Income-tax Act, a Hindu undivided family is mentioned, a Hindu co-parcenary is meant. The expression is not used in its wider sense including every Hindu joint family. It is not necessary however for the purpose of this case to enter into the discussion of this abstruse problem of Hindu Law, as the question now before us can be disposed of on other grounds.

In *Commissioner of Income Tax, Bihar & Orissa* v. *Maharani Lakshmibati Saheba* it was held that sub-section (1) of Sec. 14 of the Income-tax Act has no application to sums in which the assessee has no interest until it is actually received, which is so in the case of a person who received a maintenance allowance out of income in which he has no vested right.

In this case I cannot persuade myself to believe that the assignment is a part of the ancestral estate, nor is there any material on the record to indicate that there is any coparcenary or even joint family or joint family property, except the bare presumption that every Hindu family is joint. On the other hand, the fact that both brothers are in receipt of separate income on which they are separately assessed and that there is no joint family income which is being assessed as such leads me to think that there is no foundation for the contention that there is a joint family property. In fact there could be no blending of separate acquisitions with the assignment in question so as to make the entire property owned by the family an ancestral property. As observed by their Lordships of the Privy Council in *Shiba Prasad*

Singh v. *Prayag Kumari Debi*, at page 1421 there is a distinction in this respect between a customary impartible estate and an estate granted by the Crown subject to descent by primogeniture, and while blending may be possible in the case of the former, it is not so in the case of the latter.

Further, the one unfailing test that can be applied in this case is to determine whether the allowance would cease, if the assessee ceased to be a member of the undivided family, if any. The answer is clearly in the negative as the allowance is the gift of the Government and not the gift of the holder of the assignment or in other words, the *karta* of the family and this being so, it cannot be held in any circumstances that the assessee is receiving this income as a member of a Hindu undivided family.

Moreover, what Sec. 14 (1) contemplates is that receipt should be from the joint income of the family and not otherwise. I am aware that in *Commissioner of Income Tax, Madras* v. *Narayana Gajapathi Garu* it was observed that the question is not whether the income belongs to the *zamindar* or whether it belongs to the joint family of which the assessee is a member, but whether the assessee received his payment as a member of a Hindu undivided family. But with all respect I am disposed to think that in making this exemption the legislature did contemplate that the allowance receivable by a member must come out of the income of the Hindu undivided family and not otherwise.

Besides, in this case there is a clear remuneration of the assessee's claim to all movable and immovable property of the family in lieu of the allowance as has been stated by him unequivocally in the application of the 12th May 1927, referred to above.

On all these grounds, I am definitely of opinion that the assessee does not receive this allowance as a member of a Hindu undivided family but merely as a member of the last holder's family under the terms of Sec. 8-A (b) and this allowance he would have received even if there were no joint family and the allowance would not cease even if he separates, were there a joint family.

I would, accordingly, answer the question arising in the case and formulated by me above as follows: The allowance is exempt from tax under Section 4 (3) (viii) but not under S. 14 (1) of the Income Tax Act. I would allow the assessee his costs.

COLDSTREAM, J.—I agree.

Question answered accordingly.

[IN THE RANGOON HIGH COURT.]

COMMISSIONER ON INCOME TAX, BURMA

v.

KYAUKTAGA GRANT, LTD.

ROBERTS, C. J., LEACH and MACKNEY, JJ.

April 2, 1937.

AGRICULTURAL INCOME—LEASE OF PADDY LANDS—FALL IN PRICE OF PADDY—LANDLORD PURCHASING WHOLE CROP FROM TENANT AT HIGHER PRICE TO AVOID REDUCTION OF RENT—LOSS INCURRED, WHETHER TRADING LOSS OR LOSS OF AGRICULTURAL INCOME—PROPER METHOD OF CALCULATING PROFIT AND LOSS—METHOD OF ASSESSMENT—NATURE OF STOCK REMAINING UNSOLD.

A company had let out a vast area of paddy land to tenants. Sometime before the harvest, the management considered that at the then prevailing price of paddy the tenants would not be able to pay their rents, and as the company did not like to reduce the rents and feared that if the tenants were allowed to sell the paddy they would receive nothing, they purchased the whole crop of the tenants at Rs. 60 per 100 baskets, though the prevailing market price was only Rs. 45. In the profit and loss account the company showed that they had received the rents in full but had incurred a loss of Rs. 52,545 in paddy trading, this being the amount which the company had lost on sales of paddy bought from the tenants. The Income-tax Officer being of opinion that a loss of agricultural rent had been shown as a loss in trade, recast the paddy trading account on the basis of a purchase price of Rs. 45 and in this way arrived at a profit of Rs. 59,622;

Held, (i) *that the Income tax Officer was not entitled on these materials to re-write the accounts on the basis of Rs. 45 per 100 baskets but was bound to accept the price actually paid, namely, at Rs. 60 per 100 baskets, and the company on the other hand was not entitled to treat the rent it received as rent in kind, but was bound to treat the rent as having been received in cash out of the purchase consideration;* (ii) *the profit on the sale of the paddy must be calculated on the purchase price of Rs. 60 per 100 baskets and not at the rate of Rs. 45; and* (iii) *that the paddy that remained unsold at the end of the accounting year should be treated as paddy held for trading purposes.*

Civil Reference (No. 16 of 1936), made by the Commissioner of Income-tax, Burma, under Section 66 (2) of the Indian Income-tax Act.

Lambert, for the Commissioner of Income-tax.

Foucar, for the assessees.

JUDGMENT.

LEACH, J.—The questions raised in this reference, which is made under Section 66 (2) of the Income tax Act, 1922, concern the assessment of the Kyauktaga Grant, Limited, for the year 1935-36. The Kyauktaga grant, Limited, is a company which owns or leases about 28,000 acres of paddy land in the Pegu District. The land is let out to tenants, the company paying the land revenue due to Government. Some time before the harvest of 1933 the management of the company considered that at the price then prevailing for paddy the tenants would not be able to pay their rents to the company and interest on advances which they had received from the Lower Burma Bank Limited, a subsidiary concern. The company did not wish to reduce the rents as it thought that this would create a bad precedent. At the same time the company feared that unless the tenants could be induced to deliver over their paddy they would dispose of it to others and the company would be paid no rent. Questions relating to the Kyauktaga Grant and the tenants on the land comprised in the Grant have been before this Court from time to time and I am prepared to accept the statement that there was justification for the fear. The company accordingly decided that it would offer to buy from the tenants the whole of their paddy crop at the price of Rs. 60 per 100 baskets. Out of the moneys payable to the tenants by way of purchase consideration the company would deduct the amounts due for rent and pay the balances into the accounts which the tenants had with the Lower Burma Bank. The price of Rs. 60 per 100 baskets was Rs. 15 above the market rate and the arrangement being acceptable to the tenants the company took over the whole of the crop at this price.

The profit and loss account of the company for the year ended September 1934, which is the accounting year for the company's 1935-36 assessment showed that it had received its rents in full, but a loss of Rs. 92,545-10-9 was shown on paddy trading. This figure represented what the company had lost on sales of paddy bought from the tenants under the arrangement entered into. When the Income-tax Officer examined the accounts he

formed the opinion that a loss of agricultural rents had been wrongly shown as a loss in paddy trading. He therefore recast the paddy trading account on the basis of a paddy purchase price of Rs. 45 per 100 baskets, and in this way arrived at a net profit of Rs. 59,622, which he included in the assessment. This decision was upheld by the Assistant Commissioner on appeal. The company received altogether 812,791 baskets of paddy which it says should be divided up as follows:

(a) Received as rent in kind:	605,630	baskets.
(b) Received as a paddy trader:	126,521	,,
(c) In stock at the end of the year:	80,640	,,
Total	812,791	baskets.

With regard to (a) the company claims exemption from taxation under Section 4 (3) (viii) read with Sec. 2 (1) (b) (iii) as being agricultural income. It admits that any profits made on the sale of the 126,521 baskets which it received as a paddy trader are assessable, but contends that the calculation must be based on a purchase price of Rs. 60 per 100 baskets of paddy and not on the price of Rs. 45 per 100 baskets which the Income-tax Officer has taken. In para 7 of the order of reference the Commissioner of Income-tax has corrected the figure of 605,630 baskets said to have been received as rent in kind and says that the company should in any event allocate the 812,791 baskets of paddy as follows:

(a) Received as rent in kind:	454,253	baskets.
(b) Received as a paddy trader:	277,928	,,
(c) In stock at the end of the year:	80,640	,,
Total	812,791	baskets.

It will be observed that the company's figure of 605,630 baskets received as rent in kind has been reduced to 454,223 baskets and the company's figure of 126,521 baskets received as a paddy trader has been increased to 277,928 baskets. The reason for this is that the Income-tax Commissioner does not accept the contention that the rent has been paid in full and insists that it was only paid to the extent of three quarters. The questions which the Commissioner of Income-tax has referred to this Court for decision are:

"(1) Whether there is material for holding that the company did not receive the 454,223 baskets of paddy specified in para 7 as a receiver of rent in kind within the meaning of Sec. 2 (1) (b) (iii), Income-tax Act? (ii) If the answer to question (i) is in the

affirmative, whether the profit on the sale of the paddy in question was rightly calculated on the basis of a purchase price of Rs. 45 per 100 baskets? (iii) Whether the profit on the sale of the 277,928 baskets of paddy specified in para 7 was rightly calculated on the basis of a purchase price of Rs. 45 per 100 baskets? (iv) If the answer to question (i) is in the negative, whether the closing stock of paddy 80,640 baskets specified in para 7 should be held to be either paddy received as rent in kind or paddy held for trading purposes or whether it would be allocated *pro rata* between the two items?"

There can be no doubt that in this case the company did take over the whole of the paddy crop at the rate of Rs. 60 per 100 baskets and before us no suggestion to the contrary has been made. The Commissioner of Income-tax has however referred to this as an "alleged" purchase and has spoken of an "imaginary" price. There was no imaginary price. The tenants got in full the price which the company agreed to pay them for their paddy. The entries in the company's books cannot be treated as fictitious entries. On the materials before him the Income-tax Officer was certainly not entitled to re-write the accounts on the basis of a price of Rs. 45 per 100 baskets. He was not entitled to take a lower price than that of Rs. 60 per 100 baskets, the price actually paid. In para 11 of the letter of reference the Commissioner says:

"I know of no principle or practice which entitles the company as paddy trader to say that it paid Rs. 60 for the paddy when it could get all the paddy which it wanted in the market for Rs. 45."

But this view overlooks a material consideration. The company did not simply want to buy paddy but to secure the whole crop of their tenants. When a commodity is desired from a particular source and to the exclusion of other purchasers, it may very well be that the purchaser will have to pay a higher price than that ruling in the open market. While the Income-tax Officer was not entitled to write down the price paid by the Company for the crop, the company was not entitled to treat the rent it received as being received in kind. The transaction was on a cash basis and the company received its rent out of the purchase consideration. In accordance with those findings the answers to the questions referred will be as follows: (1) The first question will be answered in the affirmative. (2) The second and third questions will be answered in the negative. (3) The answer to the

fourth question will be that the 80,640 baskets should be treated as paddy held for trading purposes. The assessee is entitled to the costs of this reference which we fix at 15 gold mohurs. The assessee is also entitled to a refund of the Rs. 100 paid in connection with the reference.

ROBERTS, C. J.—I agree.

MACKNEY, J.—I agree.

Reference answered accordingly.

[IN THE BOMBAY HIGH COURT.]

COMMISSIONER OF INCOME TAX, BOMBAY

v.

LAXMIDAS DEVIDAS and ANOTHER.

SIR J. F. BEAUMONT, C. J., and BLACKWELL, J.

March 30, 1937.

CO-OWNERS—PERSONS JOINTLY ACQUIRING AND HOLDING IMMOVEABLE PROPERTY—WHETHER ASSESSABLE AS ASSOCIATION OF INDIVIDUALS—'ASSOCIATION OF INDIVIDUALS,' MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 3, 9 (1).

The assessees, two individuals, joined together in purchasing certain immoveable properties, contributing the purchase moneys in equal shares, and the properties were jointly held and managed by or on behalf of them. The management resulted in certain profits or gains which were shared by the assessees equally. The Income Tax Officer treated them as an association of individuals and assessed them jointly as such. The assessees claimed that each of them should be assessed individually as a co-owner on his share in the income of the properties. On a reference by the Commissioner of Income Tax:

Held—(i) *that in the circumstances of the case the assessees constituted an association of individuals within the meaning of Sec. 3 of the Income Tax Act*; (ii) *that the said association was the owner of the properties within the meaning of Sec. 9 of the Income Tax Act and were rightly assessed as such*; *and* (iii) *that in any event, the assessees were rightly assessed as owners of the said properties under Sec. 9 (1) of the Act.* Held also *that the fact that one of the individuals was a minor did not make any difference.*

PER BEAUMONT, C. J.—*The words 'association of individuals' in Sec. 3 of the Indian Income Tax Act must be construed in their plain and ordinary meaning. They are not* ejusdem generis *with the word immediately preceding, namely, 'firm'. The only limit imposed on the words is such as necessarily follows from the fact that the words appear in an Act imposing a tax on income, profits and gains, so that the association must be one which produces income, profits or gains.*

B. N. ELIAS, IN RE [1935] (I.L.R. 63 Cal. 538; 1935 I.T.R. 408; 40 C.W.N. 476; 5 I.T.C. 1) *followed.*

Mufti MOHAMMAD ASLAM *v.* COMMISSIONER OF INCOME TAX, U. P. [1936] (1936 I. T. R. 412; A. I. R. 1936 All. 817; 1936 A.L.J. 1109) *dissented from.*

Case stated by the Commissioner of Income Tax, Bombay: [Civil Reference No. 17 of 1936].

CASE.

"Under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922 (hereinafter referred to as "the Act") and at the instance of Messrs. Laxmidas Devidas and Vasanji Rattonsey (hereinafter referred to as "the assessees") I have the honour to refer to your Lordships' decision, the questions of law set out in para 6 below, which have arisen out of the income-tax assessment for the financial year 1935-36 ended on 31st March 1936.

2. **Facts of the case**:—At or about the end of the year 1933, the above named assessees, Messrs. Laxmidas Devidas and Vasanji Ruttonsey, joined together in purchasing certain immoveable properties in Bombay, contributing the purchase price thereof out of their own money in equal shares. The said Laxmidas Devidas was then a minor and his affairs were managed by his father and natural guardian Devidas Raghavji. A copy of the conveyance of the said properties in favour of the assessees is hereto annexed and marked A. Having purchased the properties as aforesaid, the assessees jointly held and managed the same for the purpose of acquiring gain and shared the income thereof equally, the minor's father and natural guardian acting throughout for and on behalf, of his son. For the purposes of the assessment to income-tax for the above financial year, 1935-36 a notice calling for return of income was issued by the Income-tax Officer under Sec. 22 (2) of the Act to the assessee and thereupon they put in a return declaring an income from the said properties of Rs. 12,941. The Income-tax Officer thereupon, after enquiries, computed the income

from the properties at the said amount under Sec. 9 of the Act and assessed the assessee as an "association of individuals" following the decision of the Calcutta High Court in the case of *Messrs. B. N. Elias and Others* v. *Commissioner of Income tax, Bengal* (63 Cal. 538). A copy of the Income tax Officer's order is annexed hereto and marked Ex. B. The income tax payable on the said income at the rate of 12 pies in the rupee together with 1/6th surcharge amounted to Rs. 943-10-0 and a demand notice for the amount was issued under Sec. 29 of the Act.

3. The assessees thereupon appealed to the Assistant Commissioner of Income-tax under Sec. 30 of the Act by their petition dated 11th May 1936, objecting to being taxed jointly on the above amount on the ground that they could not be treated as an association of individuals within the meaning of Sec. 3 of the Act and that each of them should have been assessed individually as a co-owner on his share in the income of the above properties. A copy of the appeal petition dated 11th May 1936 is annexed hereto and marked Ex. C.

4. The Assistant Commissioner heard and disposed of the appeal on 29th May 1936 confirming the order of the Income-tax Officer. A copy of the said order passed under Sec. 31 of the Act is annexed hereto and marked Ex. D.

5. Being dissatisfied with this decision, the assessees submitted to me a petition dated 29th June 1936 requesting me to refer the case under Sec. 66 (2) of the Act to this Hon. Court. A copy of the said petition is annexed hereto and marked Ex. E.

6. **Questions for the Decision of the Hon. Court** :—I submit the following questions for decision by the Hon. Court :—

1. Whether in the circumstances of the case, the assessees constituted an association of individuals?

2. Whether the said assessees can be said to be the owners of the properties within the meaning of Sec. 9 of the Income tax Act?

3. Whether the assessees were in any event rightly assessed as owners of the said properties under Sec. 9 (1) and were rightly assessed as such?

7. **Opinion of the Commissioner** :—As Sec. 66 (2) of the Act requires me to give my opinion while submitting this statement of case, I submit respectfully that the answers to the above questions should be in the affirmative. Sec. 9 (1) of the Act clearly lays down that the "tax shall be payable by an assessee under the

head 'property' in respect of the *bona fide* annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner." That this is income chargeable under the head 'property' referred to in Section 9 of the Act is undisputed. Hence tax on the annual value of the property must be levied on the owner thereof, as laid down in the said Section 9 (1) of the Act. The only question for decision is "who is the owner of the properties?" On the facts found, *viz.*, that the assessees purchased the properties jointly for the purpose of holding and using the same in order to acquire gain and remained united with each other as owners of the said properties, managing them jointly, collecting the rents jointly and paying the expenses jointly, it is submitted that it was incumbent on the Income Tax Officer to assess them as an association of individuals owning the properties. Section 9 refers to "annual value of the property consisting of any building or lands appurtenant thereto" and it is submitted that there can be no such thing as the annual value of ½ undefined part of any building and that the section on the face of it does not contemplate any division of a building into separate parts for assessment purposes or anything of the kind. Neither Laxmidas nor Vasanji is by himself the owner of the building in question. The two combined jointly owned it and as far as Section 9 goes, it clearly provides that "the tax shall be payable by the assessee who is the owner," *viz.*, the above two persons jointly.

2. The words used in Section 9 (1) are "the tax payable by an assessee........" and indeed the section is, as above suggested itself a charging section in respect of the particular head of income therein referred to, namely, property.

9. Turning, however, to the main charging section, *viz.*, Section 3, under it, tax is to be charged on every individual, undivided Hindu family, company, firm and any other association of individuals. The words "any other association of individuals" mean an association which is neither a Hindu undivided family nor a company nor a firm and the words do include persons associating together for acquiring and to hold and manage jointly house property and earn income therefrom. Hence even under Section 3 the assessment is unobjectionable. The Calcutta High Court case of *B. N. Elias and Others* (63 Cal. 538) on which the Income Tax Officer relied was, it is submitted, correctly decided.

10. A copy of your Lordships' decision may kindly be certified to me for further action as required by Section 66 (5) of the Act."

Sir K. McI. Kemp (Advocate-General) with the Government Solicitor, for the Commissioner of Income-tax.

C. K. Daphtary with *Popatlal & Co.*, for the assessees.

JUDGMENT.

BEAUMONT, C.J.—This is a reference made by the Income Tax Commissioner under Sec. 66 (2) of the Indian Income Tax Act, 1922, and the short question raised is whether the assessees are an association of individuals within the meaning of Sec. 3 of the Act.

The Commissioner finds as a fact that the assessees in the year of assessment joined together in purchasing certain immoveable properties in Bombay, contributing the purchase moneys in equal shares, that the properties were managed by or on behalf of such owners, and such management resulted in certain profits or gains. One of the assessees was a minor during the year of assessment, and he contracted through his father and natural guardian.

The short question is, whether when two persons associate together for the purpose of buying property and managing it so as to produce income they are an association of individuals within Section 3 of the Act. Now, Section 3 imposes a tax "in respect of all income, profits and gains of the previous year of every individual, Hindu undivided family, company, firm and other association of individuals." I agree with the view expressed by the Calcutta High Court in *In re B. N. Elias*, (I.L.R. 63 Cal. 538), that the words " association of individuals " have to be construed in their plain, ordinary meaning. In that case, the Court was dealing with an association of three individuals, who had combined together to purchase various properties which they proposed to manage for the purpose of making profits, and those three individuals were held to be an association of individuals within the meaning of Section 3. I think the principle of that case must apply equally where the association consists only of two individuals and there is a single property which is managed and produces income.

I cannot agree with the view expressed by the Allahabad High Court in *Mufti Mohamad Aslam* v. *Income Tax Commissioner*, (A.I.R. 1936 All. 817) that the words "association of individuals" should be read *ejusdem generis* with the word immediately preceding, *viz.*, " firm". The so-called *ejusdem generis* rule, which, I cannot help thinking, is sometimes misapplied in India, is merely a rule of construction. When you have general words following particular words, the general words are limited to things which are *ejusdem generis* with the particular words. But that rule being

one of construction should never be invoked where its application appears to defeat the general intent of the instrument to be construed. Moreover, I know of no authority for applying the rule so as to limit the meaning of general words to the last of the particular words preceding. Here, there are three associations of individuals referred to in Sec. 3 of the Act, a Hindu undivided family, a company and a firm, and those three associations of individuals are marked by widely different characteristics. A Hindu undivided family is an association united by ties of birth; members of a company are associated in such manner that they become a legal entity; and a firm is an association depending on contract but is not in itself a legal entity; and I think it would be very difficult, if not impossible, to suggest any other association of individuals which embodies substantially the peculiarities of the three particular types to which the Act refers. In my opinion, the only limit to be imposed on the words "other association of individuals" is such as naturally follows from the fact that the words appear in an Act imposing a tax on income, profits and gains, so that the association must be one which produces income, profits or gains. It seems to me that an association of two or more persons for acquisition of property which is to be managed for the purpose of producing income, profits or gains falls within the words "other association of individuals" in Sec. 3; and under Sec. 9 of the Act, the association of individuals is the owner of the property and as such is assessable.

The fact that one of the assessees during the year of assessment was a minor, does not, I think, affect the question. In point of fact, the two assessees have associated together for the purpose of the acquisition of this property. Whether or not the minor is bound by any contract entered into by his father on his behalf is immaterial for the purposes of this reference. What we have got is the ownership of property by two persons, and the production by that property of profits or gains.

The first question raised is:

"Whether in the circumstances of the case, the assessees constituted an association of individuals within the meaning of Sec. 3 of the Income-tax Act?"

In my opinion, that question should be answered in the affirmative.

The second question is:

"Whether the said association can be said to be the owner of

the properties within the meaning of Sec. 9 of the Income-tax Act, and was rightly assessed as such?"

That question must again be answered in the affirmative.

The third question is:

"Whether the assessees were in any event rightly assessed as owners of the said property under Sec. 9 (1)?"

The answer to that question would seem to follow from the answer to question No. 2 and must also be answered in the affirmative.

The assessee should pay the costs on the original side scale, less Rs. 100.

BLACKWELL, J.—I am of the same opinion. Sec. 9 (1) of the Act provides that: "The tax shall be payable by an assessee under the head 'Property' in respect of the *bona fide* annual value of the property consisting of any buildings or land appurtenant thereto of which he is the owner." According to the scheme of the Act, property is assessable in terms of that section, and not in terms of income from a business, as it is suggested by the assessee in this case that the owners of this property should be assessed. The only question with which we are concerned is, who was the owner or who were the owners of the property? On the fact as found by the Commissioner, the owners of the property are the two individuals who owned it in equal shares.

It has been contended on behalf of the assessees that they do not constitute an association of individuals owning property, that the words "association of individuals" in Sec. 3 are only referable to an association of individuals who are joined together for purposes of business and that each of the assessees should have been assessed individually as a co-owner on his share in the income from the properties. I cannot agree with this contention. If it were right, it would involve splitting up the annual rent of the property into the undefined shares of the persons who owned as tenants in common. That seems to me not permissible, having regard to the words of sub-sec. (2) of Sec. 9 of the Act, which are as follows:—"For the purpose of this section, the expression 'annual value' shall be deemed to mean the sum for which the property might reasonably be expected to let from year to year." In my view, that means the property as a whole, and not divided, separate portions of it. I think it perfectly clear that these two individuals were associated together for the purpose of acquiring the property and deriving profits from it, and that they are assessable as an association of individuals.

It has been contended that as one of the assessees at the time when the property was acquired, and during the year under assessment, was a minor, he could not be associated with the major assessee to acquire the property. I do not think we are concerned with what was the legal effect of the contract of purchase entered into. In my opinion, the minor was none the less associated with the major assessee in acquiring the property, although he was a minor at the time: and I think that all we have to decide is whether, as a matter of fact, these two persons were associated together as individuals for acquiring the property.

I agree that the questions must be answered, as they have been answered by the learned Chief Justice.

Questions answered accordingly.

[IN THE LAHORE HIGH COURT.]

B. J. HEERA v. COMMISSIONER OF INCOME TAX, PUNJAB, N.W.F. & DELHI PROVINCES.

SIR JAMES ADDISON and ABDUL RASHID, JJ.

May 13, 1936.

PROVIDENT FUND—ELECTRIC SUPPLY COMPANY—EMPLOYEE'S CONTRIBUTION TO PROVIDENT FUND—WHETHER EXEMPT—LICENCE UNDER INDIAN ELECTRICITY ACT AND ORDER UNDER TRAMWAYS ACT—EFFECT OF—'RAILWAY ADMINISTRATION', DEFINITION OF—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 15 (5)—INDIAN ELECTRICITY ACT (III of 1903)—INDIAN TRAMWAYS ACT (XI OF 1886)—PROVIDENT FUNDS ACT (XIX OF 1925), SEC. 2 (f) & (g).

The Delhi Electric Supply and Traction Co. Ltd., was an ordinary Electricity and Electric Tramway concern which was administering a tramway under a licence granted to its promoters under the Electricity Act, 1930, and an Order under the Indian Tramways Act, 1886. The assessee who was an employee of the company claimed that his contribution to the company's Provident Fund, was exempt from income tax. The provident fund was admittedly not a recognised one within Chap. IX-A of the Income tax Act, but it was contended that it was a Railway Provident Fund exempted by Sec. 15 (1). On a reference by the Commissioner: Held, *that, by being granted an Order under the Indian Tramways Act, 1886, the company did not become a company administering a tramway under a*

Special Act of the Indian Legislature, nor was it a company administering a tramway under a contract with a Local Government, though it was working under a licence granted by a Local Government; it was not therefore, a 'Railway administration' within the meaning of Sec. 2 (f) of the Provident Funds Act of 1925, and its Provident Fund was not a Railway Provident Fund within Section 2 (g) of the said Act and the employee's contribution was not, therefore, exempt from income tax under Section 15 (1) of the Income Tax Act.

Case stated under Section 66 (2) of the Indian Income tax Act (XI of 1922) by the Commissioner of Income tax, Punjab, N. W. F. and Delhi Provinces (Civil Reference No. 12 of 1936).

CASE.

"Case stated under Section 66 (2) of the Income-tax Act, referring a question of law arising from the appeal of the assessee, Mr. B. J. Heera, against 1934-35 assessment.

2. In the account period, the assessee was an employee of the Delhi Electric Supply and Traction Company: and out of his salary he contributed to the employee's Provident Fund the sum of Rs. 428, being within the maximum which might be allowable under Section 15 (3). The Fund is not one registered within Chapter IX-A of the Act. The assessee claims that the Fund is within Sec. 15 (1) of the Act: and that the above contribution should be taken out of charge accordingly. The Assistant Commissioner held that the Fund is not within the section.

3. Neither the Assessment Order, nor the Grounds of Appeal, nor the Appellate Order explains the contention, which has been left tacitly as disposed by orders which I passed, (a) on application of 35 employees of the Company under Section 33; and (b) on application of the Company under Sec. 66 (2); in respect of the 33-34 assessment. The following is the relevant part of my order in the Company's case:

"The Company is an ordinary Electricity and Electric Tramway concern, licensed under the Electricity Act, with obligation to construct and maintain its tramway on specified routes agreed with the Municipality and approved by the Local Government. Its Provident Fund was constituted from 1st January, 1926.................

"Now the Company has been pursuing the line that this Fund is one within Section 15 of the Income tax Act, *i.e.*, under the Provident Funds Act, XIX of 1925 (by amendments). That Act embraces Funds of a Railway Administration (Clause 2 (g) as

defined in clause (2) (f), of which the material part is :—" Any Company administering a railway or tramway in British India either under a special Act...........or under contract with......... a Local Government."

What they contend is that by being granted the above licence under the Electricity Act they are under "contract" with the Local Government which issued it.

Quite plainly they are not—a licence on conditions is not a contractual relationship. The clause relates to Company control of such railway as the old " Burma Railways ", run for Government by the Company under contract: or a "Tramway" like the Darjeeling Himalaya Railway, similarly run. But that matter has not the slightest relevance to the present issue, about this payment in the Company's case. It is only its employees who would be affected under Sec. 15."

4. At no stage has anything been added to the above treatment: until on my forwarding this Statement in draft for the petitioner's agreement, he has added that he relies also upon the licence under the Tramways Act. Although it is not generally desirable that new matter should be admitted at so late a stage, I have decided to amend the Statement to include this claim: but should Your Lordships hold that it alters the position materially, this may please be considered in regard to costs.

The present licence under the Electricity Act is, under the 1903 Act, contained under notification No. 123, dated 2nd March, 1935 of the Punjab Government Gazette.

The licence ("Order") under the Tramway Act, XI of 1886, is notification No. 418, dated 2nd July, 1906.

The Company is the successor to the promoters to whom these were granted.

Copies of these two notifications, and of the Rules of the Provident Fund, will be laid before the Court: but it does not appear to be necessary to make them formally an Exhibit part of the case.

5. Clause 34 of the Tramway Order expresses it to be without prejudice to the power of the Governor-General in Council to extend the provisions of the Railway Act to the Tramway: (and to be subject to the provisions of the Electricity Act and Rules). But it is not suggested that any such extention has been made (and if it had, I do not think it would be material).

6. The assessee seeks references of the following questions:—

(a) Whether the item of Rs. 428 representing the contribution

to the Povident Fund of the Company (The Delhi Electric Supply Company and Traction Company Ltd.) is not to be allowed in the petitioner's assessment for 1934-35.

(*b*) Whether the Provident Fund maintained by the Company is not one to which the Provident Funds Act of 1897, now Act XIX of 1925, applies and if so, if it does not fall within the purview of Sec. 15 (1) of the Act.

The only question which is necessary (and which is referred), is :—

"Is the Delhi Electric Supply and Traction Co., by virtue of its Licence under the Indian Electricity Act of 1903 and Order under the Indian Tramways Act of 1886, a "Railway Administration" within the terms of clause 2 (f) of the Provident Funds Act, XIX of 1925, and its Provident Fund thereby a "Railway Provident Fund" within clause 2 (g) thereof"?

7. In the Commissioner's opinion, these licences are not tantamount to "administering under contract" with Government. Nor is the Company administering under any "Special Act"—it is "administering" solely through its own company constitution; and these licensing Acts are not Special but General.

M. C. Mahajan, for the assessee.

S. M. Sikri, for the Commissioner of Income-tax.

JUDGMENT.

Under Sec. 66 (2) of the Indian Income Tax Act the Commissioner of Income tax, Punjab, North-West Frontier and Delhi Provinces, has referred the following question of law to this Court :—

"Is the Delhi Electric Supply and Traction Co., by virtue of its licence under the Indian Electricity Act of 1903 and Order under the Indian Tramways Act of 1886, a 'Railway Administration' within the terms of Clause 2 (f) of the Provident Funds Act XIX of 1925, and its Provident Fund thereby a 'Railway Provident Fund' within Clause 2 (g) thereof?"

The assessee, Mr. B. J. Heera, was an employee of the Delhi Electric Supply and Traction Co., during the accounting period. Out of his salary the assessee contributed a sum of Rs. 428 to the Employee's Provident Fund. The claim of the assessee is that this fund falls within the purview of Sec. 15 (1) of the Indian Income tax Act and the sum of Rs. 428 is not liable to income tax. The Employee's Provident Fund of the Delhi Electric Supply and Traction Co., admittedly is not one registered under Chapter XI-A of the Income tax Act.

The Provident Fund Act of 1897 was replaced by the Provident Funds Act, XIX of 1925. It was contended by the learned Counsel for the assessee that the Delhi Electric Supply and Traction Co., fell within the purview of the definition of the words "Railway Administration" as given in Sec. 2 (f) of the Provident Funds Act, 1925. It is laid down by this Act that "Railway Administration" means any company administering a railway or tramway in British India either under a Special Act of Parliament or of the Indian or a local Legislature, or under contract with the Secretary of State for India in Council, the Governor General in Council or a Local Government." It was contended that by being granted an "order" under the Indian Tramways Act (1886), the Company became one which was administering a tramway in British India under a Special Act of the Indian Legislature. We are of the opinion that this contention is devoid of all force. The Indiam Tramways Act deals with the construction of tramways in general. It is applicable to the whole of British India and was not enacted for the purpose of the construction of any particular tramway. An Act of this nature cannot be called a 'Special Act."

The only other point agitated by the learned counsel for the assessee was that at any rate the Delhi Electric Supply and Traction Co., was administering a tramway under contract with a Local Government and that the Company must, therefore, be regarded as a "Railway administration" within the meaning of Sec. 2 (f) of the Provident Funds Act. Reference was made in this connection to Secs. 7, 23, 35 and 39 of the Indian Tramways Act. After considering all the relevant sections we are of the opinion that the Delhi Electric Supply and Traction Co., was administering a tramway under a licence granted to the promoters on the 2nd July 1906, and that the Company was not administering the tramway under *contract* with the Local Government. No contract was ever entered into between the Company and the Local Government, and the licence granted to the Company under the Tramways Act was a unilateral act which could not be regarded as a contract between the Company and the Local Government. A licence granted to a company on certain conditions does not create a contractual relationship. Such a relationship can only be created by an agreement between two parties and no such agreement is referred to in the "Order" whereby the promoters of the Delhi Tramways were granted a licence on the 2nd of July 1906.

For the reasons given above, we hold that the Delhi Electric Supply and Traction Co., is not a "Railway administration"

within the purview of Sec. 2 (f) of the Provident Funds Act (1925) and its provident fund is not a "Railway Provident Fund" within the meaning of Sec. 2 (g) thereof. We answer the question referred to us accordingly. The assessee shall pay the costs of the Commissioner of Income tax.

Reference answered accordingly.

[IN THE NAGPUR HIGH COURT.]

TRIMBAK TOTARAM

v.

COMMISSIONER OF INCOME TAX, C. P. and U.P.

PURANIK, J.

August 16, 1937.

REFERENCE—COMMISSIONER'S ORDER IN REVISION MAINTAINING ASSISTANT COMMISSIONER'S ORDER REJECTING ASSESSEE'S APPEAL—WHETHER ORDER PREJUDICIAL TO ASSESSMENT—COMPETENCY OF APPLICATION FOR REFERENCE—APPLICATION, WHETHER CAN BE REGARDED AS ONE AGAINST ASSISTANT COMMISSIONER'S ORDER—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 33, 66 (2).

Under the Indian Income Tax Act as amended in 1933, no reference lies against an order of a Commissioner of Income Tax under Sec. 33 of the Act unless the order is one which involves an enhancement of assessment or is otherwise such as is prejudicial to the assessee; and if the Commissioner simply maintains the order of the Assistant Commissioner and the assessment made by him, it cannot be said that the order of the Commissioner of Income Tax is such as is prejudicial to the assessee, and the Commissioner cannot be required under Sec. 66 (3) to make a reference to the High Court.

When an appeal was dismissed by the Assistant Commissioner on 11 10-1934, an application to the Commissioner under Sec. 33 to revise the order was dismissed on 12-12-1934 and the assessee made an application on 5-2-1935 to the Commissioner to make a reference to the High Court without even indicating that he was applying for a reference of questions of law involved in the Assistant Commissioner's order : Held,—*that the application could not be regarded as one for a reference of questions of law raised in the Assistant Commissioner's order, and, as the order of the Commissioner was not prejudicial to the assessee, the application for reference was not maintainable.*

VENKATACHALAM CHETTY v. COMMISSIONER OF INCOME TAX, MADRAS [1935] (I.L.R. 58 Mad. 367; 1935 I.T.R. 55: 8 I.T.C. 74; A.I.R. 1935 MAD. 387) *followed.*

Application under Sec. 66 (3) of the Indian Income Tax Act, 1922, requesting the High Court to direct the Commissioner of Income Tax, C.P. and U.P. to state a case: (M. C. C. No. 20-B of 1936).

M. R. Bobde for the Assessee.

D. N. Chaudhury for the Commissioner of Income-tax.

ORDER

This is an application for issue of a writ of mandamus against the Commissioner of Income-tax under Sec. 66 (3) of the Income Tax Act.

2. The applicant was assessed to income tax by the Income Tax Officer, Khamgaon by an order under Sec. 23 (3) of the Income Tax Act dated 19—2—34 for the Assessment year 1933-34. An appeal was then preferred to the Assistant Commissioner, Amraoti, but it was dismissed by order dated 11-10-34. The Commissioner of Income Tax was requested to revise this order but he declined to revise (vide his order dated 12-12-34.) Thereafter the applicant applied to the Commissioner of Income-Tax, under Sec. 66 (2) accompanied by a fee of Rs. 100 requiring him to refer to the High Court the question of law arising out of the aforesaid order but the Commissioner of Income-tax refused to state the case by order dated 13—2—35. The applicant feeling himself aggrieved by this decision of the Commissioner of Income-tax has preferred this application for issue of a writ of mandamus against the Commissioner of Income-tax.

3. A preliminary objection was raised at the hearing that this application is not tenable. It is contended that under the new amendment of Sec. 66 of the Income-tax Act, no reference lies, against an order of the Income-tax Commissioner under Sec. 33 unless the order is one which involves an enhancement of the assessment or is otherwise such as is prejudicial to the assessee, but if the Income-tax Commissioner simply maintains the decision of the Assistant Commissioner and the assessment made by him, it cannot be said that the order of the Commissioner of Income-tax is such as is prejudicial to the assessee. This was the view taken in *Venkatachalam* v. *Commissioner of Income Tax, Madras* (I.L.R. 58 Mad. 367 at 369) and has been followed by a Divisional Bench of this High Court in M.J.C. No. 80 of 1935. Counsel for the

assessee replying to this objection argued that it was not proper to urge that when he applied to the Commissioner of Income Tax under Sec. 66 (2) for making a reference he was applying for an order of reference arising out of the order of the Commissioner of Income tax. It was argued that it could not be presumed that the applicant was making an untenable application if under the proviso of Sec. 66 (2) as amended no application for reference could be made. If the Income-tax Commissioner has only maintained the order of the Assistant Commissioner of Income tax it was not proper to say that the application that was made was against the order of the Commissioner of Income tax. Counsel for applicant wants me to hold that the application was one against the order of the Assistant Commissioner of Income tax and that the same has been refused. He therefore maintains that his application is tenable and that the writ should be issued against the Commissioner of Income tax. The argument of the Counsel for the applicant though ingenious has no substance. In his application to the Income tax Commissioner he has very clearly stated that he was applying for reference after the decision by the Commissioner of Income tax on 12-12-1934. He also stated therein that he received the intimation of the order on or about the 20th December 1934. This application for reference was filed before the Commissioner for Income tax on the 5th February 1935. It is idle to argue that it was an application against the order of the Assistant Commissioner of Income tax. Under the Income tax Act, an application for reference has to be filed within 60 days of the date on which the assessee is served with a notice of an order under Sec. 31 or 32 or of an order under Sec. 33 enhancing an assessment or otherwise prejudicial to him. The application before the Commissioner of Income tax was filed within 60 days of the service of a notice of an order under Sec. 33. The Commissioner of Income tax rejected that application pointing out that no reference lay inasmuch as his order did not enhance the assessment and was not such as was otherwise prejudicial to the assessee. In the application for the writ of mandamus in this court it has been very clearly stated in the application that the Commissioner of Income tax dismissed the application for review by order dated 12-12-1934 and thereupon the applicant made an application to the Commissioner of Income tax under Sec. 66 (2) requiring him to refer to the High Court the questions of law arising out of the aforesaid order and decision. Nothing could be clearer than this statement of the assessee that his application for reference to the Commissioner of Income tax

was one arising out of the order of the Commissioner himself and not from the order of the Assistant Commissioner of Income tax as is argued before me.

4. It is not disputed before me that if his application was against the order of the Commissioner of Income Tax it is not tenable, but it was tried to be argued that as the income tax case was pending at the time when the amendment permitting application for reference against the orders of Income Tax Commissioner in certain cases was introduced the amendment should not govern the case of the present assessee but his case should be governed by the Act as it was before the amendment was inserted in it. This does not in any way make the position of the assessee better. Under the old Act in no case a reference arose from an order under Sec. 33 of the Act. Reference could be made only against the order of the Assistant Commissioner of Income Tax. The assessee's counsel wants me to hold that as the old Act applied, his application must be treated as one from the order of the Assistant Commissioner of Income Tax. I am clearly of opinion that when the application was made the amendment had already come into force, it being an amendment of the year of 1933 and it was only in view of that amendment that the application before the Commissioner of Income Tax for reference was made. All pending cases will be governed by the Act so amended. The assessee has failed to make any application for reference from the order of the Assistant Commissioner of Income Tax within the stipulated period and I do not find throughout the proceedings any reference whatsoever to the order of the Assistant Commissioner of Income Tax from which a reference was sought. The argument of the respondent therefore regarding the maintainability of the application is not sound and cannot be accepted.

5. As I have already stated the assessee's counsel before me did not try to maintain that the view taken in *Venkatachalam* v. *Commissioner of Income Tax, Madras* (I.L.R. 58 Mad. 367 at 369) and followed in Mis. J. C. No. 80 of 1935 by a Divisional Bench of this Court was in any way wrong. It was not also argued before me that the order of the Income Tax Commissioner though one maintaining the order of the Assistant Commissioner was such as should be treated as otherwise prejudicial to the interests of the assessee. In fact no attempt was made for maintaining the application as one arising out of the order of the Commissioner of Income Tax though it purports to be one arising out of that order. The preliminary objection therefore prevails and the ap-

severed his connection with the firm and thereafter the business was continued by the petitioner and the remaining 2 partners. Each partner of M.A.L. Saigon and M.A.L. Rangoon was the representative of a Hindu undivided family on whose behalf he received his share of profits in these firms. One of these families became divided into two groups in 1930-31 and the share held on its behalf in the M.A.L. firms at Rangoon and Saigon was divided between the two groups equally, the representative of each becoming a partner. Thus there are at present 4 partners including the petitioner in the M.A.L. firm, Rangoon, and they are also the partners of the M.A.L. firm, Saigon. Each partner owns the same share in both the firms, *viz.*, the petitioner 1/3rd, another partner 1/3rd and each of the remaining 2 partners 1/6th. All the partners are individually assessees on the file of the Income-tax Officer, Karaikudi (II) circle. The firms in Burma are assessed by the respective Income-tax Officers in Burma.

4. For the assessment of the year 1932-33 (previous year—Tamil year Prajothpathi, corresponding to 13-4-1931 to 12-4-1932) the petitioner was originally assessed on a total income computed at Rs. 11,675 as below :—

	Rs.
Property	333
Business :	
Remittance from M.A.L., Saigon	83
Share of profit from the Al. Ve. V., Thongwa (not taxed) as reported by the Income-tax Officer, Rangoon, who assessed the firm	1,229
Share of profits from M.A.L., Thongwa (not taxed) as reported by the Income-tax Officer, Rangoon, who assessed the firm	30
Share of profits from M.A.L., Kayan and M.A.L., Rangoon taxed) (estimated)	10,000
Total income	11,675

Subsequently it was found that the petitioner's share of the profits of the M.A.L. firms in Burma was only Rs. 1,965 and I accordingly revised the assessment under Section 33. The total income as revised by me was Rs. 3,640.

5. During the year of account, the M.A.L. firm, Saigon, remitted to the M.A.L. firm, Rangoon, Rs. 59,967-8-0 as per details below :—

		Rs.	A.	P.
21-5-1931.	Remittance by telegraphic transfer through the Chartered Bank dollars 50,000 with exchange at Rs. 105¾	52,875	0	0
8-3-1932.	Remittance by means of Hong-kong and Shanghai Bank draft dollars 3,000 with exchange at Rs. 143¾	4,312	8	0
23-3-1932.	Remittance by means of Hong-kong and Shanghai Bank draft dollars 2,000 with exchange at Rs. 139	2,780	0	0
	Total ...	59,967	8	0

The M.A.L. firm Rangoon, paid Rs. 35,769-3-9 on account of hundies drawn by M.A.L. Saigon as noted below—

Date of hundi.	Date of payment in Rangoon.	Amount of the hundi. Rs.	A.	P.
30th Thai Prajothpathi (12-2-1932)	28th Masi Prajothpathi (11-3-1932)	7,375	0	0
6th Masi Prajothpathi (18-2-1932)	1st Panguni Prajothpathi (13-3-1932)	3,276	11	0
6th Masi Prajothpathi (18-2-1932)	5th Panguni Prajothpathi (17-3-1932)	7,387	8	0
11th Masi Prajothpathi (23-2-1932)	11th Panguni Prajothpathi (23-3-1932)	8,865	0	0
11th Masi Prajothpathi (23-2-1932)	26th Panguni Prajothpathi (7-4-1932)	8,865	0	0
	Total ...	35,769	3	9

In the books of the Rangoon firm, both the receipts from Saigon and the payment on behalf of Saigon were entered in the same folio styled "Saigon shop." On 5th Masi Prajothpathi, a sum of Rs. 2,054-2 6 was credited to this account being the interest due till then and at the end of the year the account was balanced with a credit of Rs. 26,133-12-6 in favour of Saigon.

6. The Income Tax Officer, Karaikudi (II) circle noticed these remittances in the course of the original assessment proceedings

against the petitioner. He however did not include any portion of the remittances in the assessment made on the petitioner but reported these figures to the Income-tax Officer, Rangoon by whom the M.A.L. firm, Rangoon was assessed. That officer proposed to tax these amounts in the hands of the M.A.L. firm, Rangoon as remittance of profit under Sec 4 (2) of the Act. But the M.A.L, firm, Rangoon contended that the firms at Rangoon and Saigon were separate and independent of each other and that the remittances received by the Rangoon firm from the Saigon firm were not assessable in the hands of the former but should be assessed in the hands of the partners individually on the strength of the ruling in Martin and Company's case reported as *Martin Co.* v. *Commissioner of Income Tax, Bengal.* The Income-tax Officer, Rangoon accepted this contention and accordingly reported to the Income-tax Officer, Karaikudi (II) circle that the proportionate share of each partner in the amount remitted from Saigon to Rangoon might be taxed in his hands. The Income-tax Officer, Karaikudi (II) circle had also other information that the petitioner's income had escaped assessment. He accordingly started on 15th January 1934 proceedings under Sec. 34 of the Act to assess the income under "Business" that had escaped assessment and to re-assess the income that had been assessed at too low a rate in the hands of the petitioner. The petitioner filed a revised return declaring an income of Rs. 19,825, against Rs. 3,640 assessed. This included only Rs. 111 on account of remittance of profits from the Saigon firm. The petitioner admitted the remittances of Rs. 59,967-8-0 mentioned above but contended that as the moneys passed from Saigon to Rangoon in the usual course of business they could not be considered to be remittances of profit to the partners of the Rangoon firms, that the Saigon agent made these remittances as he wanted to speculate in exchange, that the remittances were exhibited in the accounts as loans made by the Saigon firm to the Rangoon firm and not as profits of the partners brought to Rangoon; that the fact that the remittances had been made was before the Income Tax Officer, Karaikudi (II) circle when he made the original assessment and that therefore no income had escaped assessment within the meaning of Sec. 34 of Act, and that the sum of Rs. 35,769 paid on behalf of the Saigon firm by the Rangoon firm should be deducted from the total amount received from Saigon and to that extent the amount remitted was not liable to be taxed in any case. The petitioner further contended that the share of the profits of the Al. Ve. V. Firm, Thongwa, and

M.A.L. firm Thongwa included in the original assessment was incorrect and that in the assessment under Section 34 proposed to be made by the Income tax Officer the correct figures should be adopted.

7. The Income Tax Officer held that the proceedings under Sec. 34 were valid as the income which was sought to be assessed had not been excluded after examining the facts connected with the remittance in question and recording a definite finding as to its liability to assessment. In regard to the shares of the profits of the 2 firms mentioned above the petitioner had not appealed against his original assessment in which they had been included and therefore the Income Tax Officer held that he had no power to revise them in the proceedings under Section 34 started in order to assess the income that had escaped assessment. In regard to the contention that no profits had been remitted from Saigon to Rangoon the Income Tax Officer asked the petitioner to produce the correspondence that had passed between the petitioner's headquarters and the Saigon and Rangoon firms. The petitioner produced only 4 letters. He admitted that there were other letters but said that they could not be traced. The Income tax Officer found that at the time when the money was remitted by the Saigon firm there was a large surplus to the credit of the Saigon firm in the Chartered Bank at Saigon at a very low rate of interest without any prospect of investment in Saigon, that the Saigon firm had largely accumulated profits in excess of the amount remitted, that the Rangoon firm had largely overdrawn from the banks there and that the money was remitted from Saigon to Rangoon under instructions from the petitioner and the other partners in order to reduce Rangoon firms liabilities. The petitioner's agent admitted that there was no contract between the Saigon agent and the Rangoon agent in respect of the alleged loan. In fact there was no correspondence between them nor did the agent of the Rangoon firm execute any promissory note or other document for the amount received from Saigon. It was not part of the regular business of the M.A.L. firm, Saigon, to lend money to persons in Burma. The Rangoon firm employed large sums of borrowed money for its business and the amount remitted was utilised to reduce the Rangoon firm's indebtedness. On these facts the Income tax Officer, Karaikudi (II) circle, held that the remittances by the M.A.L., firm, Saigon, to the M.A.L. firm, Rangoon amounted, to a withdrawal to British India by the petitioner and his partners of their surplus profits available for remittance in Saigon and that the petitioner's share, *viz.*, Rs. 19,989 of the total remittances

to British India was therefore taxable in his hands. As regards the sum of Rs. 35,763 (amount paid for the hundies) claimed by the petitioner as a deduction from the remittances the Income tax Officer found that there was a long interval between the dates on which the money came from Saigon to Rangoon and the dates on which Rangoon paid money for the hundies and there was no evidence to show that the hundies were paid out of remittances. The Income tax Officer therefore disallowed this claim. The interest (Rs. 2,054) credited to the Saigon account in the books of the Rangoon firm was allowed as an expenditure in computing the profits of the M.A.L. firm, Rangoon. The Income tax Officer, Karaikudi (II) circle, therefore held that the petitioner's share of this interest, *viz.*, Rs. 684, was also income taxable in his hands. The petitioner admitted in the revised return that he had received Rs. 16,580 as interest in respect of other deposits not included in the original assessment. After allowing the interest paid and including Rs. 684 mentioned above the total interest received by the petitioner amounted to Rs. 17,248. In the result the Income tax Officer determined the petitioner's total income to be Rs. 40,877 as below :—

	Rs.
Total income according to the original assessment as revised by me ...	3,640
Remittances of foreign profits now included in the assessment ...	19,989
Interest on deposits now added ...	17,248
Total income ...	40,877

The Income tax Officer made a supplemental assessment accordingly. A copy of his order is filed marked Exhibit A.

8. The petitioner appealed to the Assistant Commissioner and objected to the inclusion in the supplemental assessment of the sum of Rs. 19,989 and Rs. 684 and some other items which are not relevant for the purposes of this application and raised the same contentions. The Assistant Commissioner found that the action taken by the Income tax Officer under S. 34 was legal, that the sum of Rs. 19,989 came out of profits and that the amounts said to have been remitted back to Saigon being the value of the hundies paid could not be deducted from the amount received for purposes of assessment, as foreign profits received in British India attract liability to British Indian income tax the moment they are

received in or brought into British India irrespective of the subsequent use made of them. He accordingly confirmed the supplemental assessment and dismissed the appeal. A copy of his order is filed, marked Exhibit B.

9. The petitioner requires me to refer to the High Court four questions marked (a), (b), (c) and (d) in the petition alleged to be questions of law arising out of the Assistant Commissioner's order. Of these, I consider it unnecessary to refer to the Court questions (a), (c), (d) and the 1st part of question (b) for the reasons given in my order of this date issued separately. In my opinion the only question of law that arises for a decision on the facts of this case is the following:

QUESTION.—Whether the sum of Rs. 59,968 remitted in 1931-32 by the Saigon partnership out of its profits to the Rangoon partnership amounted to a receipt of profits *pro tanto* by the partners in 1931-32 so as to be assessable in their hands.

The facts found are (1) that there was no regular course of business between the Saigon firm and the Rangoon firm, (2) that the Saigon agent did not speculate in exchange as contended by the petitioner, (3) that there was no contract between the agents of the Saigon firm and the Rangoon firm in respect of these remittances, (4) that the petitioner and his partners had large funds in the Saigon firm including accumulated profits available for remittance, (5) that the Rangoon firm always employed large sums of borrowed capital, (6) that the petitioner found it more profitable at the time to invest money in Rangoon than in Saigon, (7) that the money was remitted from the Saigon firm to the Rangoon firm under instructions from the petitioner and his partners to be employed in the business of the Rangoon firm, (8) that the Rangoon and Saigon firms were separate and independent of each other, and (9) that the petitioner and his partners admitted before the Income tax Officer, Rangoon, that the amount remitted to the Rangoon firm was profit taxable in the hands of the partners.

These facts, in my opinion, clearly support the conclusion that the remittance of the money by the Saigon firm was at the instance of its partners and that the money was received by the Rangoon firm on behalf of its partners. Instead of receiving the profit directly from Saigon and sending it to the Rangoon firm which was badly in need of funds the partners used the more convenient and businesslike method of asking their Saigon firm to send the amount directly to the Rangoon firm. The transaction amounted in substance to a bringing into British India of the

individual partner's proportionate shares of the remittance out of their shares of profit available for remittance in Saigon. The fact that a firm and its partners are treated as separate entities for purposes of income-tax does not alter the nature of the transaction. A firm has no separate existence apart from its partners. I am therefore of the opinion that the sum of Rs. 59,968 received by the Rangoon firm must be held to have been received by the petitioner and his partners in the ratio in which they hold shares in their firm at Saigon. The sum of Rs. 19,989 was correctly included in the petitioner's assessment. The question should be answered accordingly.

K. S. Krishnaswamy Ayyangar and *P. R. Srinivasan*, for the Assessee.

M. Patanjali Sastri, for the Commissioner of Income Tax.

JUDGMENT.

THE CHIEF JUSTICE.—The question propounded is, "Whether the sum Rs. 59,968 remitted in 1931-32 by the Saigon partnership out of its profits to the Rangoon partnership amounted to a receipt of profits *pro tanto* by the partners in 1931-32 so as to be assessable in their hands".

The assessee was and is a partner in a money-lending business carried on in Rangoon consisting of three partners under the *vilasam* of M.A.L. The same three partners are the sole partners in a similar business carried on in Saigon under the same *vilasam*. During the period commencing with the 21st May 1931 and ending on the 24th March 1932 by means of three remittances made by telegraphic transfers and bank drafts a sum of Rs. 59,967-8-0 was remitted by Saigon to Rangoon. It has been found as a fact that these remittances came out of profits made by the Saigon partnership. Under these circumstances the share of the assessee in that sum was assessed under Sec. 34 of the Indian Income tax Act. The contention put before the Income tax Officer was that the partnership itself ought not to be assessed and it appears also that the advocate who appeared before the Income tax Officer, Rangoon, who had charge of this matter admitted that the individual partners should instead be assessed. In any case, quite apart from the decision in *Martin & Co.* v. *Commissioner of Income Tax, Bengal,* that the contention of the assessee was correct and that the partnership was not liable to be assessed to income tax. The Income tax Officer then proceeded to assess

the partners individually. The contention raised before us is that they are not liable to be so assessed ; and it was strenuously argued that upon the authority of the case already referred to, this being a remittance from a separate entity, namely, the Saigon partnership, to another entity, namely, the Rangoon partnership, the partnership was not liable to be assessed. From this Mr. K. S. Krishnaswami Iyengar who appeared on behalf of the assessee contended that the partners also could not be assessed though he conceded that this sum could not escape assessment but was quite unable to state upon whom the assessment was to be made other than the individual partners of the partnership. His argument was that this was a remittance of a lump sum of profits and until there had been an allocation amongst the partners of their shares in these profits, the individual partners could not be held to have received these profits and that until there was such an allocation, it could not be said that there was any receipt by them of the profits. He relied upon the decision of this High Court in *S.L.S. Chettiappa Chettiar & others* v. *Commissioner of Income Tax, Madras.*

The answer to this contention seems to me to be this that there was admittedly a receipt in British India of profits gained abroad. By whom were those profits received? If the contention of the assessee before the Income-tax Officer was correct, then those profits were not received by the partnership in such a way as to render the partnership itself assessable. But as those profits had been received they must have been received by somebody. The only other alternative is that they were received by the partners individually and there does not seem to me to be any other possible alternative. If the partnership itself is not assessable, clearly, in my view, the individual partners are. Although it may be true that they have not received this money into their own hands, the receipt of this money by the partnership was a receipt on behalf of the partners and if, as is contended by the assessee, the decision in *S.L.S. Chettiappa Chettiar* v. *Commissioner of Income Tax, Madras*, goes to the length of saying that until there is an allocation amongst the partners of the profits there can be no receipt, with great respect I feel myself unable to agree with it. The deed of partnership of the Rangoon business sets out the shares to which each of the three partners is entitled and, the money having been received by the partnership on behalf of the partners, it is merely a matter of arithmetic to ascertain what the share in those profits of each of the individual partners is. There

is nothing in the Indian Income-tax Act which says that a partnership or a firm is to be assessed first. Either the firm itself is liable to be assessed or its individual partners. In this case an attempt was made to assess the firm and yielding to contention raised by the assessee, the firm was absolved from assessment and the individual partners were sought to be assessed. I think that the Income-tax Officer was mistaken in holding that the partnership was not liable to assessment in respect of these profits as, in my opinion, *Martin's case* already referred to does not touch this point at all. These profits therefore escaped assessment in the hands of the firm and it was open to the income-tax authorities to assess the partners individually. It seems to me that if any authority for such a procedure is needed, it is to be found in the decision in *Neemchand Daga* v. *Commissioner of Income-tax, Bengal.* In my view, the assessee was clearly assessable to income-tax in respect of his share in the sum of Rs. 59,968. The question must, therefore, be answered in the affirmative. The Commissioner of Income-tax will get Rs. 250 costs.

KING, J. :—I agree.

GENTLE, J. :—I agree.

Reference answered in the affirmative.

[IN THE NAGPUR HIGH COURT.]

HAZARI LAL *v.* EMPEROR.

POLLOCK, J.

April 20, 1937.

OFFENCE—FALSE RETURN—FALSE VERIFICATION—PRODUCTION OF FALSE ACCOUNTS—NATURE OF OFFENCES—PROSECUTION ON COMPLAINT OF INCOME TAX OFFICER WITHOUT ASSISTANT COMMISSIONER'S SANCTION—LEGALITY—INCOME TAX ACT (XI OF 1922), SEC. 52—INDIAN PENAL CODE, 1860, SECS. 177, 182, 193, 196—CRIMINAL PROCEDURE CODE, 1898, SECTION 476.

A person who makes a false return of his income to an Income Tax Officer can be prosecuted for an offence under Section 182 of the Penal Code on the complaint of the Income Tax Officer even without the sanction of the Assistant Commissioner, inasmuch as an Income Tax Officer is a Court within Section 476 of the Criminal Procedure Code.

Sec. 52 of the Income Tax Act deals only with a false statement in the verification clause and does not cover a false statement in the statement of income to which the verification clause is attached.

The fact that the assessee was bound by law to submit a return does not prevent a conviction under Sec. 182 of the Penal Code if the return is false.

Proceedings before an Income Tax Officer cannot be said to start until there is some enquiry into the income of the assessee and a statement made in a return of income is not, therefore, evidence given in a proceeding before an Income Tax Officer. An assessee cannot, consequently, be convicted of an offence under Sec. 193, Penal Code, in respect of a false statement made in the verification clause in a return of income. Sec. 52 of the Income Tax Act covers such an offence and makes it punishable under Sec. 177, Penal Code.

If an assessee produces before an Income Tax Officer false evidence to support the return made by him he can be convicted under Sec. 196, Penal Code, even though the accounts are not produced voluntarily but under the order of the Income Tax Officer.

Cases referred to :

ASST. SESSIONS JUDGE, NORTH ARCOT v. RAMAMMAL [1911] (I. L. R. 39 M. 387 ; 22 M. L. J. 141 ; 13 I. C. 275 ; 13 Cr. L.J. 35).

EMPEROR v. LACHMAN SINGH [1928] (I. L.R. 7 Pat. 715).

EMPEROR v. MOHIT KUMAR MUKERJEE [1925] (I.L.R. 52 Cal. 881 ; A. I. R. 1926 Cal. 89 ; 91 I. C. 993 ; 27 Cr. L. J. 177).

MUTHIAH CHETTY, IN RE [1911] (I. L. R. 36 Mad. 392 ; 22 M. L. J. 181 ; 13 I. C. 286 ; 13 Cr. L. J. 46).

NATARAJA IYER, IN RE [1911] (I. L. R. 36 Mad. 72 ; 23 M. L. J. 393 ; 16 I. C. 755 ; 1912 M. W. N. 1012 ; 13 Cr. L. J. 723).

PUNAMCHAND MANEKLAL, IN RE [1914] (I.L R. 38 Bom. 642).

QUEEN EMPRESS v. RAMJI SAJABARAO [1885] (I.L.R. 10 Bom. 124).

SULTAN v. MAJOR WELBOURNE [1925] (I. L. R. 3 Rang. 577 ; A. I. R. 1925 Rang. 364 ; 90 I. C. 316).

Criminal Revision No. 52 of 1937 decided on 20-4-37 arising out of the Judgment in Criminal Appeal No. 269 of 1936, given by the Additional Sessions Judge on 26-1-1937, Criminal Case No. 3 of 1936.

Sir Harising Gour, for the Applicant.

J. Sen, Standing Counsel, for the Crown.

JUDGMENT.

The applicant Hazarilal has been convicted under Secs. 182, 193 and 196, Indian Penal Code, and sentenced in the aggregate to one year's rigorous inprisonment and a fine of Rs. 1,000.

2. The Income-tax Officer issued a notice to Hazarilal under Sec. 22 (2) of the Indian Income-tax Act requiring him to furnish a return, in the prescribed form and verified in the prescribed manner, of his total income during the previous year. Hazarilal submitted the return Ex. P. 1 duly verified and dated 14-5-34 showing his total income for the year as Rs. 896-4-6. The Income-tax Officer did not accept this return as correct and issued notices to Hazarilal under Secs. 22 (4) and 23 (2) of the Act, calling upon him (i) to produce his account (ii) to attend at the Income-tax Officer's office to produce or to cause to be there produced any evidence on which he relied in support of his return. Hazarilal appeared before the Income-tax Officer on 16-6-34 when he amended the return so as to show his total income for the year as Rs. 754-7-9 and he produced his accounts and also certain statements which the Income-tax Officer demanded. The Income-tax Officer came to the conclusion that these accounts were false and Hazarilal was eventually assessed to an income of Rs. 8,000.

3. Hazarilal was prosecuted on a complaint by the Income-tax Officer. There are three charges.-- The first is that on 14-5-34 he gave information to the Income-tax Officer intending thereby to cause him to exempt him from payment of income-tax and thereby committed an offence under Sec. 182 of the Indian Penal Code. It has been contended that the offence, if any, was one under Sec. 177 of the Indian Penal Code read with Sec. 52 of the Indian Income-tax Act and that in the absence of the Assistant Commissioner's sanction, the conviction cannot stand. Sec. 52 of the Income-tax Act provides that if a person makes a statement in a verification mentioned in certain sections of the Act which is false, and which he either knows or believes to be false, or does not believe to be true, he shall be deemed to have committed the offence described in Sec. 177 of the Indian Penal Code. The return submitted by Hazarilal consisted of a statement of his total income during the previous year and appended to that statement was a verification clause. Sec. 52 of the Income-tax Act deals only with a false statement in the verification clause and does not cover a false statement in the statement of income to which the verification clause is attached.

4. In *Sundaram's Law of Income-tax in India*, third edition, page 947, it is stated that the provision in Sec. 52 is without prejudice to that in Sec. 476 of the Criminal Procedure Code under which a Court can direct a prosecution in respect of the offences mentioned in that section and committed before the 'Court', and that all the Officers, Assistant Commissioners and Commissioners are evidently 'Courts' for this purpose. It was held in *Nataraja Iyer In re* and *In re Punamchand Maneklal* that an Income-tax Officer is a revenue Court, and Subhedar, A.J.C., took the view in Criminal Revision No. 193 of 1933, that it is open to the Income-tax Officer to act under Sec. 476, Criminal Procedure Code, and make a complaint of the offence committed before him. I think there is no doubt that this view is correct.

5. It is further argued that Hazarilal was bound to submit the return of income and that Sec. 182 of the Indian Penal Code applies only to information given voluntarily. Sec. 182 runs as follows: " Whoever gives to any public servant any information which he knows or believes to be false......" and there appears to me to be no ground for taking the section to mean that the information must be voluntarily given. In support of this view I may cite the decisions in *Queen Empress* v. *Ramjee Sajabarro*, *King Emperor* v. *Lachmansingh* and *Sultan* v. *Major Welborne*. In submitting a false return Hazarilal could no doubt have been prosecuted under Sec. 177 of the Indian Penal Code, but there is, as the learned Additional Sessions Judge has pointed out, an additional element in Sec. 182 and that is that the information is supplied with the intention of causing a public servant to do or omit anything which he ought not to do or omit if the true state of facts were known by him. It has been contended that there is no proof that the statement of income submitted by Hazarilal was in fact false, and that all that has been proved is that there were certain omissions in the account. There are concurrent findings of both courts that receipts have been omitted from the accounts and false entries of expenditure have been inserted in order to balance the accounts and that finding must be accepted in revision. The statement of income was based on the account books, and as those account books have been found to be false it necessarily follows that the statement of the income was false. The conviction under Sec. 182 is therefore upheld.

6. The second charge was that Hazarilal on 14-5-34 in the course of judicial proceedings before the Income-tax Officer stated in evidence that the return of income given by him was a true and

complete statement of the income received, which statement he either knew or believed to be false or did not believe to be true, and thereby committed an offence punishable under Sec. 193 of the Indian Penal Code. This charge is based on the verification clause attached to the statement of income. Sec. 52 of the Income tax Act states that such a false verification is an offence under Sec. 177 of the Indian Penal Code. The lower Courts, however, have held that it amounted to giving false evidence in the proceedings before the Income-tax Officer and is therefore an offence under Sec. 193 of the Indian Penal Code. Sec. 37 of the Indian Income-tax Act provides that any proceedings before an Income-tax Officer under Chapter IV shall be deemed to be a 'judicial proceeding' within the meaning of Secs. 193 and 228 and for the purposes of Sec. 196 of the Indian Penal Code. I do not think that the proceedings before the Income-tax Officer can be said to start until there is some enquiry into the income of the assessee, and in my opinion a statement made in the return of income is not evidence given in a proceeding before the Income-tax Officer. Sec. 52 of the Income-tax Act provides for the punishment of such an offence, making it punishable under Sec. 177 of the Indian Penal Code and from this it appears to me that it was not intended that it should also be punishable under Section 193. On the second charge therefore Hazarilal must be acquitted.

7. The third charge is that Hazarilal on or about 16-6-34 in the course of judicial proceedings before the Income tax Officer corruptly used or attempted to use as true or genuine evidence which he knew to be false or fabricated and thereby committed an offence punishable under Secs. 193-196 of the Indian Penal Code. It has been contended that Hazarilal produced his account books merely because he was ordered to do so by the Income-tax Officer and that he could not therefore be said to use them as evidence. I have been referred to the decisions in *Assistant Sessions Judge, North Arcot* v. *Ramammal* and *Re Muthiah Chetty*. I agree that where a forged document has merely been produced in compliance with an order by the Court it cannot be said to have been used as evidence. But I do not think that no offence can be committed under Sec. 196 if the document has been produced in compliance with the order of the Court. As PAGE, J. has pointed out in *Emperor* v. *Mohit Kumar Mukerjee* "whether there has been an 'user' or not depends upon the circumstances of each case", and the question whether there has been a fraudulent or dishonest user is one of fact. In the present

case Hazarilal in the enquiry before the Income-tax Officer relied on his accounts in his attempt to show that his return of income was true. He therefore used or attempted to use the accounts as true or genuine evidence. The conviction under Secs. 196/193 is therefore upheld.

8. Lastly it has been contended that Hazarilal is an old man who should not be sent to jail. Hazarilal's age is given as 60. A sentence of imprisonment must be passed under Sec. 196. The sentence of six months' rigorous imprisonment under Sec. 182 is upheld. The sentence of one year's rigorous imprisonment and a fine of Rs. 1,000 awarded for the two offences under Secs. 196 and 193 will be reduced to a sentence of six months' rigorous imprisonment and a fine of Rs. 2,000 for the offence under Secs. 196/193. The sentence of imprisonment will run concurrently. The sentence in the aggregate will therefore be six months' rigorous imprisonment and a fine of Rs. 2,000. In default of payment of the fine the accused will undergo rigorous imprisonment for a further period of six months.

Sentence reduced.

[IN THE NAGPUR HIGH COURT.]

MULLA FIDA ALI SULTAN ALI

v.

COMMISSIONER OF INCOME-TAX, C.P. & U.P.

POLLOCK, J., and DIGBY, J.

September 22, 1937.

FIRM—APPLICATION FOR REGISTRATION AS FIRM—POWER OF INCOME TAX AUTHORITIES TO FIND THAT PARTNERSHIP DEED WAS NOT INTENDED TO BE ACTED UPON—FINALITY OF FINDING—MOTIVE OF MEMBERS HOW FAR MATERIAL—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 26-A.

The question whether the terms of a deed constitute a partnership is quite different from the question whether the deed itself is a sham one not intended to be acted upon.

If the income tax authorities find that a deed of partnership is a sham and not intended to be acted upon and there is evidence on which they could arrive at such a finding, the High Court will not weigh the evidence with a view to deciding as court of appeal whether the finding is correct or otherwise.

Obiter: *If a partnership has in fact been formed, the motive with which it was formed is immaterial.*

Cases referred to:

ABOWATH BROS. *v.* COMMISSIONER OF INCOME TAX, BURMA [1935] (7 I.T.C. 38).

AYRSHIRE PULLMAN MOTOR SERVICES & DAVID M. RITCHIE *v.* COMMISSIONERS OF INLAND REVENUE [1929] (14 Tax Cas. 754; 8 App. T.C. 531).

BISSESSWAR LAL BRIJLAL In re [1930] (I.L.R. 57 Cal. 1226; 4 I.T.C. 365).

SOOKINABHOI SALEBHOY *v.* COMMISSIONER OF INCOME TAX, BOMBAY [1935] (6 I.T.C. 13).

JUDGMENT.

1. The assessee, Mulla Fida Ali Sultan Ali, submitted his return of income for the year 1934-35 and an application was made under Sec. 26-A of the Indian Income Tax Act for registration of a firm purporting to have been brought into existence by a partnership deed dated 25-7-1932 which was to come into force on 30-10-1932. The members of the firm constituted by this deed were Mulla Fida Ali Sultan Ali and his major sons.

The deed is as follows:

(1) That the partnership shall commence from *Kartik Sudhi* one, 1938 *Sambat.*

(2) That the working partners shall have no interest in and right and title to the assets, the rolling stock, the goods, the capital of the shop run under the name and style of Mulla Fida Ali Sultan Ali.

(3) That the financing partner shall be the sole and exclusive owner of all the assets, goods, capital and running stock of the aforesaid shop.

(4) That the working partners shall be entitled merely to the share of the profit specified herein below.

(5) That the financing partner shall get 7 as. in a rupee by way of his share from the profits of the year after deducting the necessary business expenses. He shall be responsible for losses and damages to the extent of 7 as. in the rupee.

(6) That the working partners shall each get 3 as. in the rupee by way of their share from the profit of the business after deducting the necessary business expenses. Each of them shall be held responsible to the extent of 3 as. in the rupee for the losses

or damages that may accrue after the commencement of this partnership.

(7) That the working partners shall each deposit with the financing partner Rs. 2,500 by way of security for any losses incurred in the business or any damage caused by them or any of them.

(8) That the financial year of the partnership shall commence from *Kartik Sudhi* one of *Sambat* year to the *Aso Wadi Amavas.*

(9) That the account of the partnership business and the profits or losses therein shall be settled at the end of the financial year.

(10) That the working partners shall be fully responsible for the efficient and the proper working of the partnership business.

(11) That the working partners shall maintain complete and regular accounts of the partnership business. That the financing partners shall be fully entitled to inspect the accounts at any business time he likes.

(12) That the working partners shall have no power of attorney to contract any loan or to incur any debt for or on behalf of the partnership business and in the name of the firm and the shop of Mulla Fida Ali Sultan Ali.

(13) That the working partners shall not lend or advance any goods of the shop or sell any articles on credit without the express consent of the financing partner.

(14) That subject to the restrictions stated in clauses 12 and 13 hereunto before, the working partners shall have all powers proper and necessary for the efficient management and the working of the partnership business.

(15) That no business other than that done at present shall be started or done by the working partners without the written consent of the financing partner.

(16) That the working partners shall under no circumstances draw on their own account any sum in any month exceeding Rs. 100.

(17) That the financing partners shall have the power of terminating the partnership of all or any of the working partners after giving one full month's notice to the partner concerned.

(18) That the working partners or any of them shall be at liberty to retire from the partnership after giving one full month's notice on that behalf to the financing partner.

(19) That the working partners or any one of them while retiring or being removed from partnership shall explain and render all accounts in their charge to the financing partner to his full and entire satisfaction.

(20) That the financing partner shall in case of misdemeanour or misconduct or gross negligence of the working partners or any of them shall have the power of removing them forthwith from the partnership.

The Income-tax Officer refused the application.

A similar application had been made towards the end of 1932 and rejected by an order dated 5-1-1933. A second application had been made in 1934 and rejected early in that year.

The reasons why the application was rejected on 5-1-1933 were that clauses 2, 3, 4, 12, 13 and 16 of the deed appeared to the Income-tax Officer to indicate that the deed was a camouflage devised with a view to evade the proper rate of taxation by transferring the so called firm to the status of a registered firm. As regards clause 7, the Income-tax Officer had ascertained by inquiry that Rs. 2500 had been borrowed from Seth Najat Ali of Khandwa at 9 per cent. per annum and he appears to have considered that this sum would not be advanced to the sons without security unless there were an assurance that the father would pay the money. The order was mainly based on suspicion aroused by the terms of the deed. In 1933-34 registration was refused because it was admitted that no additional evidence could be produced by the applicant for registration. In 1934-35 a third application was as mentioned above refused and the order of refusal is set out below :—

'The assessee has again put in an application for registration of the alleged firm of Fida Ali Sultanali. It was held in 1932-33 case that no firm has in fact come into being and that the business and property belong individually to Mulla Fida Ali Sultanali. It was further held that the partnership deed dated 25-7-1932 was in effect bogus and did not bring into being a genuine partnership. This finding was confirmed in appeal and revision in that year. Similarly registration was refused in 1933-34 case also and the appeal against the refusal was rejected.

"This year again the assessee has put in an application for registration on the basis of the same deed, viz., deed of 25-7-1932. It is admitted there is no additional evidence to be produced besides that produced in 1932-33 case. I must therefore hold that no firm has in fact come into being and that Mulla Fida Ali Sultanali

is the sole proprietor of all business and property. A passing reference is made by Ibrahimkhan in his statement to a fresh deed of partnership not yet executed in which the alleged partners have been given some additional powers of selling on credit up to a certain limit. As the deed is not before me and is not yet executed, I refrain from commenting about it. But the intention of Mulla Fida Ali to keep the sole proprietorship to himself is apparent. In this connection the application dated 12-5-1934 and the power of attorney filed in 1934-35 can go to show that Fida Ali is the owner. As there is no additional evidence and as the matter was already decided, I refuse registration and hold that no firm exists at all and that it is only a firm which is entitled to registration."

An appeal was made and the Assistant Commissioner of Income-tax came to the following conclusion : "From a perusal of the terms of the partnership deed and as also from the facts found by the Income-tax Officer it is perfectly clear that this partnership does not fulfil the requirements of Secs. 5 and 6 of the Partnership Act.

The following question has been referred to this court arising out of the proceedings :—

"Whether in the circumstances of this case there was evidence before the Income-tax Officer to hold that no genuine firm had come into existence within the meaning of Sec. 26-A of the Act."

It is argued by the learned Advocate for the assessee that the terms of the deed clearly constitute a partnership. It is also pointed out that the motive with which a partnership may be formed is immaterial, reliance being placed on *Ayrshire Pullman Motor Services & David M. Ritchie* v. *Commissioners of Inland Revenue*. We fully agree with both these contentions and consider that if the deed were real, there would be no question that it would bring into existence a firm. We find ourselves unable to accede to the arguments advanced on behalf of the Commissioner of Income-tax that any or all of the clauses in the deed are inconsistent with the formation of a partnership.

This however is not the question. The material point is whether there was evidence before the Income-tax Officer on which he was entitled to decide that the deed was a sham and was not intended to be acted on. It has been very clearly pointed in *Bisseshwarlal Brijlal, In re*, that the Income-tax Officer is not bound to accept such a document at its face value and can require the applicant to adduce evidence from which he may satisfy himself

of the bona fides of the applicant. "A deed is not a magical talisman".

The case of *Sookinaboi Salebhoy* v. *The Commissioner of Income-tax, Bombay*, relied on by the learned Counsel for the Commissioner of Income Tax is distinguishable from the present case because the terms of the deed were such in themselves as to show that they could not constitute a partnership. The case reported in *Abowath Bros.* v. *The Commissioner of Income Tax, Burma*, is also distinguishable from the present case on the ground that the facts on which the deed of partnership was held to be unreal were extremely strong. The case however is a good authority for the proposition that the Income Tax Officer can as stated in the Calcutta case enquire in the question of fact whether the partnership is real or is a sham. And indeed in the Scottish case relied on by the assessee, it is said, "The agreement could not have stood for a minute if it had been possible to say of it on the facts that it was either a fraud or a mere simulative arrangement."

It is argued before us by the learned Advocate for the assessee that the partnership deed creates a presumption which must be rebutted by evidence which would convince a court of justice. We do not however consider that that is the proper way in which to view the matter or that it is our function to weigh the evidence in front of the Income-tax Officer with a view to deciding as in a court of appeal whether such presumption was in fact rebutted. We take the view that the Income tax Officer was entitled to satisfy himself whether the deed was real or was a sham before deciding to register the firm.

There was the following evidence before the Income tax Officer in September 1934.

(1) The fact that the accounts as is admitted before us showed distribution of profits according to the terms of the deed.

(2) The fact that there were 2 previous decisions adverse to the applicant.

(3) The fact that the applicant had no further evidence to adduce.

(4) The fact that since the formation of the alleged firm it had not been thought necessary to change the powers of attorney given by the father at a time when he was admittedly sole owner of the business.

In our judgment failure to adduce more evidence, failure of the members of the firm to expose themselves to cross examina-

tion, failure to adduce the evidence of Najatali who could clearly state whether any agreement with the father collateral to the contract of loan with the sons did or did not exist, entitled the Income tax officer to draw, if he chose, an adverse inference. Again the matter of the powers of attorney might have admitted of any explanation had the firm members given evidence. It may be that the Income tax officer placed more weight on this matter than we should, but that was a matter for him. In the circumstances we are unable to say that there was no evidence before the Income tax Officer on which he could hold that the deed was a sham and we therefore answer the reference in the affirmative and allow costs of Rs. 100 to the Commissioner of Income tax to be paid by Mulla Fida Ali Sultanali.

Reference answered in the affirmative.

[IN THE BOMBAY HIGH COURT.]

COMMISSIONER OF INCOME TAX, BOMBAY

v.

VISVANATH BHASKAR SATHE.

SIR J. W. F. BEAUMONT, C. J., and BLACKWELL, J.

March 23, 1937.

DEPRECIATION OF MACHINERY—MACHINERY NOT USED BUT KEPT READY FOR USE UNDER POOLING AGREEMENT—CLAIM FOR DEPRECIATION, WHETHER ALLOWABLE—'USED', MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 10 (2) (vi).

The word 'used' in Sec. 10 (2) (vi) of the Indian Income Tax Act should be understood in a wide sense so as to embrace passive as well as active user. When machinery is kept ready for use at any moment in a particular factory under an express agreement from which taxable profits are earned, the machinery can be said to be used for the purposes of the business which earns the profits although it is not actually worked, and depreciation allowance can be given in respect of such machinery under Sec. 10 (2) (vi) of the Indian Income Tax Act.

The assessee owned a ginning factory and was a member with the owners of other ginning factories, of a pool. During the year of assessment, the factory of the assessee was not employed in the work of ginning in accordance with the pooling agreement, though

he received a share of the profits. The assessee was however, under the agreement bound at his own expense to keep his gins and other working plant and machinery in good repair and condition and working order even when his factory was not working, so that it may be ready for actual use at any moment: Held, *on a reference by the Commissioner, that in these circumstances the assessee was entitled to allowance on account of depreciation in respect of the plant and machinery of his factory under Sec. 10 (2) (vi) of the Act, even though they were not actually engaged in any work in the year.*

Cases referred to:

BHIKHAJI VENKATESH *v.* COMMISSIONER OF INCOME TAX, C.P. and U.P. [1936] (8 I.T.C. 410; 1937 I.T.R. 626).

RADHAKISHEN & SONS *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1929] (3 I.T.C. 73).

SHRI GOPALJI CO. *v.* COMMISSIONER OF INCOME TAX, PUNJAB, [1932] (5 I.T.C. 267; 1931 Comp. Cas. 299; A.I.R. 1931 Lah. 376; 32 P.L.R. 335).

Case stated by Mr. F. R. Merchant, Commissioner of Income Tax, Bombay Presidency, under Sec. 66 (2) of the Indian Income Tax Act, in the matter of the assessment of Mr. Viswanath Bhaskar Sathe of Dhulia for 1935-36. The Commissioner's statement of the case was as follows:

CASE.

"Under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922 (hereinafter referred to as "the Act"), and at the instance of Mr Vishwanath Bhaskar Sathe of Dhulia, manager of the Hindu undivided family under assessment (hereinafter referred to as "the assessee"), I have the honour to refer to your Lordships for favour of decision the question of law set out in para 4 below which has arisen out of the income tax assessment of the assessee for the financial year 1935-36 ended on 31st March 1936.

2. **Facts of the Case**:—The assessee is the owner of a ginning factory and during the financial year joined a pool formed by several owners of such factories in Dhulia. In accordance with the agreement with the pool, only some of the factories were allowed to work and the others remained idle getting, of course, their share in the profits earned by the pool. The assessee's factory remained idle accordingly but duly received its share in the profit made under the arrangement.

3. For the assessment year 1935-36 which is under dispute, the assessee submitted his return of income showing therein an income of Rs. 3,258-8-0 after deducting Rs. 2,380 on account of depreciation in respect of the building, machinery and plant pertaining to his ginning factory. After examining the accounts produced in support of the return, the Income Tax Officer, West Khandesh, assessed him on a total income of Rs. 5,722 disallowing the above claim for depreciation to the extent of Rs. 2,380 on the ground that as the factory remained idle during the year of account, no such allowance was admissible. A copy of the Assessment Order passed is annexed hereto and marked Exhibit A. The assessee appealed against the disallowance contending that though the machinery was not actually put to any use, he had, under the pool agreement, to keep the factory ready for actual working and for that purpose he was compelled to keep the machinery and building in good order. A translation of the petition of appeal and a copy of the grounds of appeal are annexed hereto and marked Exhibit B. The Additional Assistant Commissioner of Income Tax, Central Division, Nasik, who heard the appeal, however, confirmed the Income Tax Officer's order for the reasons given in his decision, a copy whereof is annexed hereto and marked Exhibit C. The assessee has, in consequence, by his application dated 19th March 1936 (a copy whereof is annexed hereto and marked Exhibit D), applied for a reference to the High Court under Sec. 66 (2) of the Act. I accordingly submit for decision this Statement of the case.

4. **Question for the decision of the Court** :—I submit for decision the following question of law :—

" Whether in the circumstances of the case, the Income Tax Officer was correct in deciding that the assessee was not entitled to any allowance on account of depreciation under Sec. 10 (2) (vi) of the Act ? "

5. **Opinion of the Commissioner** :—As Sec. 66 (2) of the Act requires me to give my opinion while forwarding this statement of case, I beg to state that the answer to the question should be in the affirmative. It is an admitted fact that during the year of account concerned, viz., *samvat* year 1990, the factory was lying idle so that the income that was taxed was not earned by working it. The claim falls under Sec. 10 (2) (vi) under which an allowance in respect of depreciation " of *such* buildings, machinery, plant or furniture " is admissible; and the word " such " italicised by me refers to the buildings, machinery, plant or furniture " used for the purposes of the business." In the present case, the factory was

lying idle and was not used for the purposes of the business. Hence no depreciation allowance was admissible, as decided by the Judicial Commissioner, Nagpur, in the recent case (in which the facts were very similar to those in the present case) of *Bhikaji Venkatesh* v. *Commissioner of Income Tax, Central and United Provinces*. Reference may also be made to the decisions of the Lahore High Court in the cases of *N. D. Radha Kishen & Sons* v. *Commissioner of Income Tax, Punjab* and *Shri Gopalji Company* v. *Commissioner of Income Tax, Punjab*.

6. A copy of your Lordships' decision may be certified to me for further action as required by Sec. 66 (5) of the Act."

The Advocate General, with the *Government Solicitor*, for the Commissioner of Income Tax.

G. M. Joshi, for the assessee.

JUDGMENT.

BEAUMONT, C. J.—This is a reference made by the Commissioner of Income Tax under Sec. 66 (2) of the Indian Income Tax Act, which raises a question lying in a very small compass, but one easier to state than to answer.

It appears that the assessee, during the year of assessment, which was the year ending March 31, 1936, owned a ginning factory in Dhulia, and he was a member, with the owners of other ginning factories, of a pool. The Commissioner finds as a fact that during the year of assessment the factory of the assessee was not actually employed in the work of ginning; and presumably, it was not so employed under some arrangement made by the pool, although I have not been referred to any clause of the pool agreement under which factories of some of the members can be closed. But under clause 16 of the agreement, it is provided as follows :—

"In order to entitle the parties hereto to keep their respective shares in the said pool as mentioned in clause 7 hereof, they shall keep and maintain at Dhulia during the continuance of this agreement his or their gins or other working plant with the machinery appertaining thereto as they exist at date of this agreement and shall at all times at their own expenses keep the same in good repair and condition and in working order and shall not during the said term remove or permit to be removed any such gins or machinery at Dhulia to any other place or places: Provided always that any of the parties hereto shall be at liberty if they so desire to close his or their factory or factories and dis-

pense with his or their staff and workmen for any period during the contract period, retaining nevertheless his or their right to receive his or their share in the said pool."

That clause appears to impose on the assessee the obligation during the year of assessment at his own expense to keep his gins and other working plant and machinery in good repair and condition and working order; and it is on account of this obligation that he becomes entitled to a share of the profits made by the pool.

The question is, whether, in these circumstances, the Income Tax Officer was correct in deciding that the assessee was not entitled to any allowance on account of depreciation of the machinery in his cotton gin. Now, depreciation is allowed under Sec. 10 (2) (vi) of the Indian Income Tax Act "in respect of depreciation of such building, machinery, plant or furniture, being the property of the assessee" at the rates specified therein. To find out what "such" machinery, plant or furniture means, we have to refer to sub-sec. (iv) of Sec. 10 (2) which authorises an allowance in respect of insurance of machinery, plant and furniture used for the purposes of the business. The question, therefore, resolves itself into this—was the machinery of the assessee during the year of assessment used for the purposes of the business from which his profit was derived? I agree with the view expressed by the Commissioner of Income Tax, and in the cases to which he refers, that "used" denotes actual user, and not merely being capable of being used. But that does not dispose of the question whether, when machinery is kept ready for use at any moment in a particular factory under an express contract from which taxable profits are earned, the machinery can be said to be used for the purposes of the business which earns the profits, although it is not actually worked. To my mind, it is so used. The business from which the profits were derived was that of ginning factories, and the contribution of the assessee to that business was the obligation to keep his machinery ready for actual use at any moment. It is, no doubt, true, as the learned Advocate General says, that it is possible to give the word "used" a more limited meaning and hold that it includes only the actual work of the machinery, and it is urged that it is that working which occasions depreciation. But I think that the word "used" in this section may be given a wider meaning and embraces passive as well as active user. Machinery which is kept idle may well depreciate, particularly during the monsoon season. It seems to me that the ultimate test is, whether, without the particular user of the machinery relied upon

the profits sought to be taxed could have been made; and as I read the agreement in the case, the profits of the assessee during the year under assessment could not have been earned except by his maintaining his factory in good working order, and that involves the user of the factory and the machinery. That view is not in any way inconsistent with the views of the Lahore High Court in *Shri Gopalji Company* v. *Commissioner of Income Tax, Punjab and N.W.F. Provinces* and in *Radha Kishen & Sons* v. *Commissioner of Income Tax, Punjab*, where the facts were different. The case of *Bhikaji* v. *Commissioner of Income Tax, Central and United Provinces*, is no doubt nearer to this case, but it does not appear from the report of that case that there was any covenant to maintain the machinery in question in reserve ready for actual use during the year of assessment; and I base my decision entirely on the existence of such a covenant in the case.

In my opinion, the question raised must be answered in the negative. We allow the assessee costs on the original side scale.

BLACKWELL, J. :—I agree.

Reference answered.

NOTE : The case of *Bhikaji Venkatesh* referred to in the above judgment is reported below :—

[IN THE NAGPUR JUDICIAL COMMISSIONER'S COURT.]

BHIKAJI VENKATESH *v.* THE COMMISSIONER OF INCOME TAX, C. P. & U. P.

STAPLES and NIYOGI, A. J. Cs.

July 15, 1935.

DEPRECIATION OF MACHINERY—POOLING AGREEMENT—FACTORIES WORKING IN ROTATION—OWNER OF MACHINERY NOT WORKED DURING YEAR OF ACCOUNT, WHETHER ENTITLED TO DEPRECIATION ALLOWANCE—INDIAN INCOME TAX ACT (XI of 1922), Sec. 10 (2) (vi).

The assessee who owned a ginning factory joined a pool of the owners of such factories. Under the pooling agreement the factories worked in rotation and during the year of account the assessee's factory did not work, though he received his share of the profits out of the pool. Held, *on a reference by the Commissioner, that, as the assessee's machinery and plant were not actually used for the purposes of the business he was not entitled to an allowance for depreciation under Sec. 10 (2) (vi) of the Indian Income Tax Act.*

Cases referred to:

RADHA KISHEN & SONS *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1929] (3 I.T.C. 73).

SRI GOPALJI CO. *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1931] (5 I.T.C. 257; 1931 Comp. Cas. 299; A.I.R. 1931 Lah. 376).

SADHUCHARAN ROY *v.* COMMISSIONER OF INCOME TAX, BENGAL [1935] (1935 I.T.R. 114; 62 Cal. 804; 39 C.W.N. 730; 156 I.C. 394; A.I.R. 1935 Cal. 344: 8 I.T.C. 177).

Case stated under Section 66 (2) of the Indian Income-tax Act (XI of 1922) by the Commissioner of Income Tax, Central and United Provinces [Miscellaneous Judicial Case No. 46-B of 1934].

CASE.

"Case stated by the Commissioner of Income tax, Central and United Provinces, under Sec. 66 (2) of the Indian Income tax Act (XI of 1922, hereinafter referred to as the Act) at the instance of Rao Bahadur Bhikaji Venkatesh, Managing Proprietor, Balkishendas and Dravid Press Factory, Yeotmal, an unregistered firm (hereinafter referred to as the assessee), for the decision of the Honourable Judges of the Judicial Commissioner's Court, Nagpur, of the question of law set out in paragraph 2 of the application made by the assessee, arising out of the appellate decision of the Assistant Commissioner of Income tax, Nagpur, dated July 21st, 1934, in respect of the assessment to income tax for the year 1932-33.

2. **Facts of the case.**—The assessee does the business of pressing cotton bales. For the assessment year 1932-33, the assessee returned an income of Rs. 7,656 which was not accepted. After examining the accounts produced in support of it, the Income tax Officer assessed it in the amount of Rs. 10,052 after disallowing (1) Rs. 2,312 on account of depreciation at the appropriate rate on the original cost of the pressing machinery and (2) Rs. 84 depreciation on that of the additions to it, on the ground that the machinery remained idle in the year of account. A copy of the assessment order is annexed as Appendix A. The assessee appealed contending that though the machinery was not actually put to use in consequence of its belonging to a combination in which it had entered in the year of account it had to be put in proper repair and working condition. The Assistant Commissioner overruled this contention and confirmed the Income tax Officer's assessment order. A copy of the appellate order is annexed as Appendix B. The assessee has now made a petition under Sec. 33 and also one for a reference (Appendix C) under Sec. 66 (2). I am at one with the Assistant

Commissioner and unable, therefore, to give the assessee the desired relief in full. So far as its claim for depreciation on buildings is concerned it has been allowed by me.

3. **Questions for the Decision of the Honourable Court.**—I accordingly refer the question of law propounded by the assessee in a slightly modified form:—"When in consequence of its having entered into a combination with other factory owners, the machinery in dispute remained idle in the year of account, was the assessee entitled nevertheless to depreciation on it, considering that it had to be kept in good repairs and working order?"

4. **Opinion of the Commissioner.**—The decision of the question turns on the interpretation of the words "used for the purposes of the business" occurring in Sec. 10 (2) (iv). It is not disputed that they govern sub-clauses (v) and (vi) also. The question for determination is whether they require that the machinery should be actually in use during the year of account. It is respectfully submitted that in interpreting a statute no extraneous arguments need be invoked if a consistent answer can be found within the four corners of the statute itself. Sec. 10 does not specify any period of time. But it is controlled by Sec. 3 which in turn has reference to the "previous year"—a definite expression under the Act. The words in question should therefore, it is humbly submitted, be construed as referring to the use of the machinery during the year of account. If, therefore, the machinery remained idle in the year of account, as it admittedly did in this cas no depreciation could be allowed. I am supported in this opinion by the decision of the Lahore High Court as reported in *Radha Kishen & Sons* v. *Commissioner of Income tax, Punjab.* In my opinion the question should be answered in the negative.

JUDGMENT.

This is a reference under Sec. 66 (2) of the Income Tax Act by the Commissioner of Income tax, Central and United Provinces. The facts are not in dispute, and the only question for determination before us is whether the assessee, Rao Bahadur Bhikaji Venkatesh, was entitled to any allowance in respect of depreciation of buildings, machinery, plant or furniture under Sec. 10 (2) (vi) of the Act for the year in respect of which the assessment was made.

Rao Bahadur Bhikaji Venkatesh owns a ginning factory at Yeotmal and has joined a pool of several owners of such factories. According to the working arrangement of the pool all the factories do not work in the same year, but some work and some remain

idle in rotation. During the year, for which the assessment was made, admittedly the assessee's factory did not work, though he received his share of profits out of the pool. The assessee's contention is that, even though the machinery did not work, the factory and machinery were still used for the purpose of the business within the meaning of Section 10 (2) (iv). This contention has been negatived by the income tax authorities, and the view put forward by the Commissioner in the reference is that the buildings, plant or machinery must be actually used for purposes of the business during the year, or else no allowance can be made for depreciation. This is the view that has been taken in *Radha Kishen & Sons* v. *Commissioner of Income Tax, Punjab.*

The learned Counsel for the assessee contended that the words "used for the purpose of the business", occurring in Section 10 (2) (iv), were general and only meant "such as were generally used or might be used for the purposes of the business" and not "actually used during any particular year. We cannot however, accept that contention. Apart from the plain meaning of the word "used" which must be taken to mean "actually used", and not "capable of being used" or "generally used", we would agree with the commentary in *Sundaram's Law of Income tax in India*, page 516 of the third edition, that Section 3 governs the whole Act, and that in Section 10, where an allowance has to be made covering a longer period than one year, the definite proviso is inserted to meet the case. As already stated above, it is admitted that the assessee's factory and machinery were not actually used for the purposes of the business during the year. The case, therefore, in *Sri Gopalji & Co.* v. *Commissioner of Income Tax, Punjab*, appears to us to be in point. There, as in the present case, the machinery, plant and buildings belonging to the Sri Gopalji Company were not actually used in the business which was carried on by the company during the year, but were used for the purposes of other business, and it was held that the company could not claim any allowance on account of depreciation. The case in *Sadhucharan Roy* v. *Commissioner of Income Tax, Bengal*, does not appear to us to be in point, because there the question was of a lease, and it was held that the owners, and not the lessees, could claim depreciation under Section 10 (2) (iv): but the buildings, plant and machinery were, as a matter fact, actually used.

Even the argument derived from clause (iv) of Sec. 10 (2), that in that clause "used for the purposes of the business", does not mean "actually used" but only "generally used", seems to

us to have little, if any, force; because that clause deals with insurance against risk of damage or destruction, and there can be no doubt that such insurance would be very materially affected by the question whether the buildings, machinery, plant, etc., were actually used during the year or were lying idle; in other words, if they were lying idle, insurance would presumably be effected at a very much lower rate. We do not think, then, that any safe deduction can be made from clause (iv) of Section 10 (2) with regard to clause (vi) of that Section. We must hold, as indicated above, that in the latter clause, though the words "such buildings, machinery, plant, or furniture" would mean "buildings, machinery, plant or furniture used for the purposes of the business," "used", must here mean "actually used" and not generally used or "capable of being used". Nor can we give any weight to an argument put forward by the learned Counsel for the assessee that actually there was more depreciation in the case of machinery that was not used than when it was under use. Whether this is a fact or not, we do not know, but in any case we hold it to be irrelevant and the case must be governed by the Act and not by any such general considerations.

We therefore hold on the reference that with regard to clause (vi) of Sec. 10 (2) of the Act the words "used for the purposes of the business," occurring in clause (iv) of that section, mean "actually used" and that in a case such as the present, where the buildings, plant and machinery were not actually used during the year no allowance can be granted on account of depreciation. Under Section 66 (5) of the Act we deliver judgment accordingly and send a copy to the Commissioner under the seal of the Court.

Cost of the reference shall be paid by the assessee. We fix pleader's fee at Rs. 50.

Reference answered accordingly.

[IN THE ALLAHABAD HIGH COURT.]

RAJMANI DEVI

v.

COMMISSIONER ON INCOME TAX, U. P.

COLLISTER and BAJPAI, JJ.

May 4, 1937.

BEST JUDGMENT ASSESSMENT—ORDER REFUSING TO CANCEL ASSESSMENT—APPEAL TO ASSISTANT COMMISSIONER—REFERENCE FROM ORDER REJECTING APPEAL—MAINTAINABILITY—'PREVENTION BY SUFFICIENT CAUSE', WHETHER CAN INVOLVE QUESTIONS OF LAW—ILLEGALITY OF NOTICE, WHETHER SUFFICIENT CAUSE —NOTICE UNDER SEC. 23 (3)—OMISSION TO GIVE ASSESSEE CHOICE OF ATTENDING IN PERSON OR PRODUCING EVIDENCE—VALIDITY OF NOTICE—NOTICES UNDER SECS. 23 (2) AND 22 (4)—NOTICE UNDER SEC. 23 (2) INVALID—BEST JUDGMENT ASSESSMENT FOR NON-COMPLIANCE WITH NOTICE UNDER SEC. 22 (4)—LEGALITY OF ASSESSMENT—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 22 (4), 23 (2), 23 (4), 27.

Though in the majority of cases no question of law would ordinarily arise out of the decision of an Assistant Commissioner dismissing an appeal against an order of the Income Tax Officer under Sec. 27 refusing to cancel an assessment under Sec. 23 (4), it cannot be said that no question of law can ever arise in such a matter.

The illegality of a notice, non-compliance with which has brought about a best judgment assessment, can be agitated within the expression 'prevented by sufficient cause' in Sec. 27, and can be made the subject of a reference to the High Court under Sec. 66.

The choice as to whether the assessee should attend the Income Tax Officer's office or whether he should produce or cause to be produced any evidence on which he may rely in support of the return, in response to a notice under Sec. 23 (2) of the Income Tax Act lies with the assessee and not with the Department. A notice under Sec. 23 (2) which merely calls upon the assessee to attend the Income Tax Officer's office and does not give him the choice of producing or causing to be produced any evidence on which the assessee may rely in support of the return is, therefore, irregular and invalid.

If an Income Tax Officer believes that a return made by an assessee is incorrect or incomplete he is bound to serve on the assessee the notice mentioned in Sec. 23 (2).

Although the issue of a valid notice under Sec. 23 (2) is not a condition precedent to an assessment under Sec. 23 (4), yet where the Income Tax Officer has reason to believe that the return is incorrect or incomplete he is bound to issue a valid notice under Sec. 23 (2) and if this is not done he cannot proceed to make a best judgment assessment under Sec. 23 (4) for mere non-compliance with a notice issued under Sec. 22 (4).

An Income Tax Officer believed a return made by the assessee to be correct and issued two separate notices to the assessee, one under Sec. 22 (4) for production of accounts and the other under Sec. 23 (2) to attend in person. For non-compliance with the notice under Sec. 22 (4) he made an assessment under Sec. 23 (4). It was however found that in the printed notice issued under Sec. 23 (2) the words 'or produce or cause to be produced any evidence on which he may rely in support of the return' were scored out and that the notice was therefore invalid: Held, *that whether the issue of a valid notice under Sec. 23 (2) was a condition precedent or whether it was only imperative in the circumstances of the case, the assessee was denied a valuable right and he was therefore, prevented by sufficient cause from complying with the notice issued under Sec. 22 (4).*

Dictum : *In order to avail himself of Sec. 27 of the Act, the assessee must satisfy the conditions laid down in that section in connection with the particular notice, non-compliance with which brought about the best judgment assessment.*

Cases referred to :

ABDUL BARI CHOWDURY *v.* COMMISSIONER OF INCOME TAX, BURMA [1931] (I.L.R. 9 Rang. 281 ; A.I.R. 1931 Rang. 194 ; 133 I.C. 81 ; 5 I.T.C. 352).

CHETTYAR FIRM, A. K. P. R. L. A. *v.* COMMISSIONER OF INCOME TAX, BURMA, [1931] (I.L.R. 9 Rang. 98 ; 132 I.C. 718 ; A.I.R. 1931 Rang. 25 ; 5 I.T.C. 187).

HARMUKHRAI DULICHAND, IN RE [1928] (I.L.R. 56 Cal. 39 ; 114 I.C. 90 ; 32 C.W.N. 710 ; A.I.R. 1928 Cal. 587 ; 3 I.T.C. 198).

KAJORIMAL KALYANMAL, IN RE [1930] (122 I.C. 741 ; A.I.R. 1930 All. 209 ; 1930 A.L.J. 78 ; 3 I.T.C. 451).

JOT RAM SHER SINGH *v.* COMMISSIONER OF INCOME TAX, U. P. [1934] (1934 I.T.R. 129 ; 7 I.T.C. 173 ; 150 I.C. 197).

MOHANLAL HARDEODAS *v.* COMMISSIONER OF INCOME TAX, BIHAR & ORISSA [1930] (I.L.R. 9 Pat. 172 ; 10 P.L.T. 769 ; 122 I.C. 810 ; A.I.R. 1930 Pat. 14 ; 5 I.T.C. 62).

MUHAMMAD HAYAT v. COMMISSIONER OF INCOME TAX, PUNJAB [1931] (I.L.R. 12 Lah. 129; 32 P.L.R. 563; 131 I.C. 31; A.I.R. 1931 Lah. 87; 5 I.T.C. 159).

PALLUMAL BOLANATH, IN RE [1933] (1933 A.L.J. 1474; 146 I.C. 759; A.I.R. 1933 All. 541; 1933 I.T.R. 235).

RAMASAMI CHETTIYAR v. COMMISSIONER OF INCOME TAX, MADRAS [1929] (I.L.R. 52 Mad. 194; 56 M.L.J. 141; 116 I.C. 566; A.I.R. 1929 Mad. 60; 3 I.T.C. 290).

SADARAM PURANCHAND, IN RE [1931] (A.I.R. 1931 Cal. 729; 134 I.C. 1275; 5 I.T.C. 459).

RAMKHELAWAN UGAM LAL v. COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA [1928] (I.L R. 7 Pat. 852; 9 P.L.T. 655; 114 I.C. 211; A.I.R. 1928 Pat. 529; 3 I.T.C. 225).

Case stated by the Commissioner of Income Tax, C. P. and U. P. under Sec. 66 (3) of the Indian Income Tax Act (XI of 1922) in the matter of the assessment of one Lala Ramjidas for the assessment year 1932-33. [Mis. Case No. 320 of 1935].

The facts of the case were simple and are stated in the Judgment. The questions referred were :—

1. Was the notice under Sec. 23 (2) issued to the assessee irregular by reason of the fact that a wrong year was mentioned and by reason of the fact that the words in the printed notice 'or to produce, or cause to be there produced any evidence on which such person may rely in support of the return' were scored out?

2. Is the issue of a valid notice under Sec. 23 (2) a condition under the circumstances of the present case to the making of an assessment under Sec. 23 (4)?

3. If the issue of the above notice is a condition precedent, is an assessee justified in disobeying a notice under Sec. 22 (4) and can he be said to be prevented by sufficient cause from complying with the said notice?

S. K. Dar, *M. N. Agarwala* and *Brij Lal Gupta* for the Applicant.

K. Verma for the Opposite Party.

JUDGMENT.

This is a reference under Sec. 66 (3) of the Indian Income-tax Act, XI of 1922. The proceedings in connection with which the reference arose were proceedings under Sec. 27 of the Act and the assessment year was the year 1932-33 ending with *Chait* 1989. The assessee was one Lala Ramji Das who was a banker and carried on money-lending business on an extensive scale. He maintained

his accounts by the year ending on the 15th *Chait* which corresponds roughly with the financial year. The previous year or the accounting year would in the present case end with the 15th of *Chait* 1988. When the assessment began Ramji Das was alive, but he died on April 9, 1933, and the application under Sec. 27 which was submitted by Ramji Das, was continued by his widow Mst. Rajmani Devi. The Income tax Officer dismissed the application under Sec. 27 on April 13, 1934, and an appeal against the said decision was dismissed by the Assistant Commissioner on July 24, 1934. On August 27, 1934, the assessee filed a combined application for review and reference to the High Court. On October 8, 1934, the learned Commissioner refused to state a case and on the application for review he remitted certain issue to the Income tax Officer. We are not concerned in the present proceeding with the result of the application for review. The assessee, then filed an application in the High Court praying that we should require the Commissioner to state a case under Sec. 66 (3) of the Act. By our order dated February 27, 1936, we required the Commissioner to state a case and formulated three questions of law. We mentioned then that the only matter which we had to decide at that stage was whether a question of law arose out of the decision of the Assistant Commissioner, and we were of the opinion that the three questions formulated by us did arise and we did not agree with the opinion of the Commissioner that no question of law arose although counsel for the department also pressed that point before us even at that stage.

The learned Commissioner has now stated a case and has referred the three questions of law which we had ourselves formulated, but once more he has lodged a mild protest questioning our jurisdiction in requiring him to state a case under Sec. 66 (3), for he is still of the opinion that a question of law did not arise. He thinks that a question of law is foreign to an appeal pending before the Assistant Commissioner against an adverse order passed by an Income tax Officer under Sec. 27. He says:

'The expression 'prevented by sufficient cause' in Sec. 27 involves some definite active cause, making compliance with a notice impossible and not a passive cause such as the opinion that compliance is not obligatory because of rights supposed to be secured under the Act.'

This means that if an applicant wishes to submit that he was prevented by sufficient cause from complying with the terms of a notice, the applicant must allege and prove some such fact as illness

or accident etc., and a decision on this point would obviously be a decision on a question of fact. The learned Commissioner is further of the opinion that it is not possible for an applicant to say that he was prevented by sufficient cause from complying with the notice, because the notice was illegal. We may state at the very outset that we cannot agree with the general proposition that it is not possible to evolve a question of law out of the various circumstances mentioned in Sec. 27 of the Act.

It now remains to discuss a few decisions of some of the High Courts on which reliance has been placed by the learned Commissioner. They are the cases of *Jot Ram Sher Singh* v. *Commissioner of Income-tax*; *Mohan Lal Hardeo Das* v. *Commissioner of Income-tax, Bihar and Orissa*; *In re Abdul Bari Chowdhary* v. *Commissioner of Income-tax, Burma* and *A.K.R.P.L.A. Chettiar Firm* v. *Commissioner of Income-tax, Burma.* In *Jot Ram Sher Singh's* case the matter that was directly decided by this Court was that a question whether an assessment under Sec. 23 (4) is valid or not is not a question of law that arises or can arise out of an order of the Assistant Commissioner passed under Sec. 31, and consequently such a question cannot be made the ground for an order by the High Court under Sec. 66 (3) requiring the Commissioner to state a case, and therefore that case is not of any help to the point that we are at present considering. The learned Commissioner, however, has made reference to a certain passage occurring at page 277 of the Allahabad Law Journal Reports. The passage is:

" A refusal to make a fresh assessment under Sec. 27 can proceed only on the ground that the assessee was not prevented by any sufficient cause from complying with the notice under Section 22 or Sec. 23. *If any question of law arises from such refusal it can certainly be the subject of reference under the order of the High Court.* But any question of law which arises from the best judgment assessment sought to be set aside by an application under Sec. 27, cannot fall within the purview of Sec. 27."

From the words which we have underlined it is clear that the learned Judge was of the opinion that a question of law can arise from a refusal by the Income-tax Officer to cancel an assessment under Sec. 27 of the Act. This case, therefore, does not in any way support the opinion of the Commissioner. The Patna case also has no bearing on the present matter, for all that was decided in that case was that where an application under Sec. 27 of the Income-tax Act to reopen an assessment under Sec. 23 (4) for failure to produce account books called for under Sec. 22 (4) was dismissed

by the Income-tax Officer and an appeal therefrom was rejected by the Assistant Commissioner, such questions alone, within the terms of Sec. 27 of the Act, which could have been taken on the appeal before the Assistant Commissioner, could be raised on a reference to the High Court under Sec. 66 and not questions regarding the assessment under Sec. 23 (4) which is not appealable under Sec. 30 (1) proviso. It would thus appear that all that was decided in this case was that as the assessment under Sec. 23 (4) was not appealable no question regarding such assessment could be raised in proceedings under Sec. 27 and it was not decided as a general proposition that no question of law could arise in proceedings under Section 27. On the contrary the case decides that certain questions may form the subject of a reference under Section 66. The same may be said about the Rangoon case of *Abdul Bari Chowdhury*. Here also the question that was directly decided was that no question of law arises out of the Assistant Commissioner's order in an appeal against a best judgment assessment because of the proviso to Section 30 (1), and in the body of the judgment Page, C. J., observed:

"Under Section 27, however, the Income-tax Officer has to determine whether the assessee was prevented by sufficient cause from complying with the requirements of the law as set out in Sec. 27. That is *essentially* a question of fact and not of law."

We also agree that in the majority of cases no question of law would ordinarily arise out of the decision of an Assistant Commissioner dismissing an appeal against an order of the Income-tax Officer under Sec. 27, but we are not prepared to subscribe to the view that no question of law can ever arise in such a matter and that the illegality of a notice, non-compliance with which has brought about a best judgment assessment, cannot be agitated within the expression "prevented by sufficient cause." We have left for the last the consideration of the case reported in 9 Rang. p. 25 (*A.K.R.P.L.A. Chettiyar Firm* v. *Commissioner of Income Tax, Burma*). The facts of the case are not stated at length in the reports, but the learned Judges observed as follows:

"The order of March 23, 1930, was made in an appeal under Section 30 (1) from a refusal of the Income-tax Officer, under Sec. 27 to cancel the assessment and proceed with a fresh assessment upon the ground that he was not satisfied that there was sufficient cause shown by the assessee preventing him from producing the Shan States accounts pursuant to the notice duly served on him in that behalf under Section 22 (4). In such an appeal

the question whether the assessment was properly made or not was immaterial........."

So far there is nothing which militates against the view that we are taking, but the learned Judges proceed and observe:

"and it was equally immaterial whether the notice, which admittedly was served upon the assessee, calling upon him to produce the Shan States accounts, was valid or not."

This last passage, standing in the cryptic form in which it stands, undoubtedly favours the view taken by the Commissioner, and if it implies that the question about the validity of a notice can never in any form, as the basis of any allegation within the purview of Sec. 27, become the subject of a reference under Sec. 66 out of the appellate ouder of the Assistant Commissioner, then we respectfully beg to dissent from it.

On the authority of the cases mentioned above including the Allahabad case, it is well settled that where the Assistant Commissioner rejects an appeal *in limine* on the ground that the proviso to Sec. 30 (1) bars any appeal against an assessment under Sec. 23 (4), the question whether an assessment under Sec. 23 (4) is valid or not is not a question of law and cannot be made the subject of a reference to the High Court. It may be further mentioned that the proviso to Sec. 30 (1) bars not only an appeal against an assessment made under Sub-Sec. (4) of Sec. 23 but an appeal against an assessment under that sub-section read with Sec. 27, and in the two Rangoon cases mentioned above, although the cases arose out of the proceedings under Sec. 27, pointed reference was made to the proviso to Sec. 30 (1) of the Act, and it may be that in those two cases the appeal against the decision of the Income tax Officer under Sec. 27 was dismissed by the Assistant Commissioner under the proviso to Sec. 30 (1). If that is so, then obviously no question of law can arise and the decision would be in line with the decision of the Allahabad High Court in *Jot Ram Sher Singh's* case.

We may, however, mention that under Sec. 66 a reference can be made in connection with any question of law arising out of an appellate order passed by the Assistant Commissioner under Sec. 31. A perusal of Sec. 31 makes it quite clear that an appeal does lie under that section to the Assistant Commissioner from an order of the Income-tax Officer refusing to make a fresh assessment under Sec. 27 and the Assistant Commissioner may confirm such order or cancel it and direct the Income-tax Officer to make a fresh assessment. If, therefore, any question of law can arise

out of the appellate order of the Assistant Commissioner we fail to see why such a question cannot be made the subject of a reference under Sec. 66. If, however, after having cancelled an assessment under Sec. 27, the Income-tax Officer proceeds to make a fresh assessment he has under Sec. 27 to make it in accordance with the provisions of Sec. 23, and if while making this fresh assessment he has once more to invoke the aid of Sec. 23 (4) because of any default made by the assessee and an appeal is filed against that order, then the Assistant Commissioner would be entitled to reject the appeal *in limine* under the proviso to Sec. 33 (1), and on the authorities mentioned it would not be possible to argue that any question of law arises out of the order of the Assistant Commissioner rejecting the appeal. So far as the present case is concerned, it is clear that the Assistant Commissioner did not and could not reject the appeal against the Sec. 27 order passed by the Income-tax Officer under the proviso to Sec. 30 (1) but could at worst only confirm the order of the Income-tax Officer under Sec. 31 of the Act, and we are of the opinion that if a question of law arises from the appellate order of the Assistant Commissioner it can certainly be made the subject of reference under the orders of the High Court and as a matter of fact when we directed the Commissioner to state a case we were of the opinion that the three questions of law which we formulated for the benefit of the Commissioner did arise, and we now propose to give our opinion on the said three questions which have been referred to us.

It might, however, be convenient to state a few facts in order to appreciate the questions. In the course of the assessment year 1932-33 ending with the 15th of *Chait* 1989 a notice under Sec. 22 (2) for the filing of a return was issued on April 1, 1932. After some extensions, with which we are not concerned, the return was submitted on September 3, 1932. On October 15, 1932, the Income-tax Officer issued two separate notices, one under Sec. 22 (4) for the production of accounts and a second under Sec. 23 (2) requiring the assessee to attend in person. The date fixed for the appliance of the above two notices was October 20, 1932. The assessee appeared on October 20, 1932, and produced certain books. From that date till about December 22, 1932, the accounts were scrutinised and witnesses were examined. The Income-tax Officer came to the conclusion that all the account books required in pursuance of the notice under Sec. 22 (4) were not produced and the assessee's explanation for their non-production was unsatisfactory. He, therefore, thought

that there was a default which entitled him to proceed under Sec. 23 (4) and he made a best judgment assessment. The appeal against that judgment was rejected by the Assistant Commissioner, and in connection with proceedings under Sec. 27 the Commissioner, as we have mentioned before, stated the present case only after a direction by us.

The first question of law that has been referred to us is:—

"Was the notice under Sec. 23 (2) issued to the assessee irregular by reason of the fact that a wrong year was mentioned and by reason of the fact that the words in the printed notice 'or to produce, or to cause to be there produced any evidence on which such person may rely in support of the return' were scored out?"

On October 15, 1932, a notice under Sec. 22 (4) and another under Sec. 23 (2) were issued. Sec. (2) says:

"If the Income-tax Officer has reason to believe that a return made under Sec. 22 is incorrect or incomplete he *shall* serve on the person who made the return a notice requiring him, on a date to be therein specified, either to attend at the Income-tax Officer's office or to produce, or to cause to be there produced, any evidence on which such person may rely in support of the return."

The notice that was issued in the present case is printed at page 12 of the case. It is as follows:

"To enable me to test the correctness of the return made by you under Sec. 22 of Act XI of 1922 for the year ending *Chait Sambat* 1988, I hereby require you to attend in person on October 20, 1932."

It is argued on behalf of the assessee that there were two irregularities in this notice. The first irregularity is that the year ending *Chait Sambat* 1988 was mentioned, though the correct year which ought to have been mentioned was the year ending *Chait Sudi* 15, *Sambat* 1989. The learned Commissioner has rightly pointed out that this did not in any way mislead the assessee and we might further mention that the assessee did appear in person and did not lodge any protest in respect of this mistake. Moreover, the difference is only that of fifteen days and the account books, such as were furnished, were in respect of the correct year ending *Chait Sudi* 15, *Sambat* 1989. The proceedings in connection with which the notice was issued related to the year ending *Chait Sudi* 15, *Sambat* 1989 and these were the only proceedings pending at that time and the assessee knew perfectly well what account books he was required to produce. We are, therefore, of

the opinion that this irregularity does not in any way vitiate the notice.

The other irregularity is a more serious irregularity, and it is that the words "or to produce, or to cause to be there produced any evidence on which such person may rely in support of the return" were scored out. The contention on behalf of the assessee is that out of the alternatives provided in Sec. 23 (2) it is for him and not for the Department to choose the alternative. There are three alternatives provided by Sec. 23 (2)—

(1) to attend at the Income-tax Officer's office,

(2) to produce any evidence on which the assesseee may rely, and

(3) to cause to be there produced any evidence on which the assessee may rely.

In the present case the Income-tax Officer did not give the assessee the option of choosing any one of the three alternatives but asked the assessee to attend the Income-tax Officer's office. The learned Commissioner says:

"It is the Income-tax Officer, when he arrives at a certain frame of mind, who is required to give a notice and it is for him, I submit, to decide which of the alternatives he will choose. If he thinks that for his purposes it will be enough that the assessee came and explained how he had made out the return, there is no reason why he should enforce the other alternative, particularly when he knows that such an explanation would be supplemented by the accounts he had required the assessee under Sec. 22 (4) to produce. It is the Income-tax Officer who has, in a certain frame of mind, to issue the notice and the alternatives would appear to be intended for him."

There is no question of enforcing the other alternatives. The question is whether it is not the privilege of the assessee to choose one of the several alternatives provided by the section. If the contention of the Department were correct, then the word "either" ought more appropriately to have occurred at a different place and the section might read as follows:—

"He shall serve on the person who made the return a notice either requiring him on a date to be therein specified to attend ......or......".

But as the section reads the alternatives seem to be for the benefit of the assessee who has got to choose as to which of the options he will exercise. This is also more reasonable. The assessee has submitted his return and the Income-tax Officer has

reason to believe that the return is incorrect or incomplete, and although the Income-tax Officer may be of the opinion that the explanations furnished by the assessee might remove the Officer's suspicion, yet the assessee might feel that no amount of explanations furnished by him would remove the doubts of the Officer, and it would be necessary for him to produce some evidence in support of the return, and if the notice directed only the attendance of the assessee the latter would not be able to produce valuable evidence. It may also be that the assessee might find it extremely inconvenient to attend in person and at the same time might feel that the Officer could be given every satisfaction by the production of some evidence. From every point of view we are of the opinion that the law intended to give the options to the assessee and not to the Department. It was contended by Mr. Varma on behalf of the Department that if the law were interpreted in the way in which we feel inclined to interpret it, the position would become unworkable. He said that if the option were with the assessee, then under certain circumstances there could be no default in compliance with a notice under Sec. 23 (2) and the Income-tax Officer could never proceed to pass a best judgment assessment. The illustration that he gave was that the assessee who admittedly keeps no accounts and whose calling does not necessarily involve the keeping of accounts might on a notice issued under Sec. 23 (2) decide to attend at the Income-tax Officer's office and not to produce any evidence with the result that even though the Income-tax Officer may not be satisfied with the explanation of the assessee the Income-tax Officer would not be able to say that there was non-compliance with the notice and would have to proceed under Sec. 23 (2), and in that case he would be compelled to accept the return filed by the assessee. There is really no substance in this contention, because first it was never intended that the Income-tax Officer should invoke the powers vested in him under Sec. 23 (4) in the majority of cases and further if the assessee chooses not to produce any evidence in support of the return it might really work to the detriment of the assessee because then the Income-tax Officer might utilise the information which he has received about the income of the assessee and might place that information before the assessee and ask him to displace the same. The Income-tax Officer might well summon certain witnesses under Sec. 37 of the Act to show what the income of the assessee is and on the basis of that evidence—the assessee being given the option to cross-examine such witnesses

—proceed to assess the individual on an income higher than that stated in the return and public revenues would not in any way suffer. Further the same difficulties would arise if the option were with the Officer. He might decide to ask the assessee to attend in person or he might decide to ask the assessee to produce evidence in support of the return and in either event it is conceivable that the Income-tax Officer may remain unsatisfied, and if the Income-tax Officer knows that the assessee keeps no accounts he would not issue a notice under Sec. 22 (4) and he will have to proceed under Sec. 23 (3). It seems to us that if the Income-tax Officer were the final Judge in the matter of the alternatives it would work great hardship on the assessee and the assessee in those cases in which the Income-tax Officer requires only the attendance of the assessee might lose the valuable right of producing the evidence in support of the return and removing the doubts of the Officer. Our answer to the first question is therefore, in the affirmative. In view of a certain passage in the judgment of the Income-tax Officer in the Sec. 27 proceeding, it was argued that the question was only academic and did not really arise. The passage is :—

"After he had his full say and had produced all the evidence at his disposal he informed me by his letter dated December 22, 1932, that he did not want to adduce any further evidence because he had produced all the evidence which he wanted to adduce".

This is not at all a correct statement of facts and we are satisfied after what has been said by counsel that the assessee did not produce any evidence under Sec. 23 (2).

The second question that has been referred to us is :—

"Is the issue of a valid notice under Sec. 23 (2) a condition precedent under the circumstances of the present case to the making of an assessment under Sec. 23 (4) ?"

A plain reading of Sec. 23 (2) shows that under certain circumstances the issue of a notice under the above provision is mandatory and the question is whether it was so mandatory under the circumstances of the present case. The notice starts by saying : "To enable me to test the correctness of the return made by you". It is therefore, clear that the Income-tax Officer had reason to believe that the return filed by the assessee was incorrect or incomplete and moreover the very fact that a notice under Sec. 23 (2) was issued shows that the Income-tax Officer had reached that frame of mind when he was not satisfied with the correctness of the assessee's return. The law provides that if that frame of

mind has been reached the Income-tax Officer *shall* serve on the person who made the return a certain kind of notice. There can, therefore, be no doubt that under the circumstances of the present case a notice under Sec. 23 (2) was imperative. In the case of *Muhammad Hayat Haji Muhammad Sardar* v. *Commissioner of Income-tax*, Shadi Lal, C. J., at page 134 observed as follows :—

"If he, however, considers the return to be incorrect or incomplete, he had no authority to reject it and to make the assessment to the best of his judgment as he is entitled to do when no return is made. He must give the assessee an opportunity to prove the accuracy and completeness of the return made by him and he is, therefore, enjoined by Sec. 23, Sub-sec. (2) to serve on the latter a notice requiring him either to appear at the office of the Income-tax Officer, or to produce or to cause to be produced, evidence in support of his return."

A clear injunction is laid on the officer and the injunction must be obeyed. In connection with the first question we were of the opinion that the notice that was issued in the present case under Sec. 23 (2) was an irregular and invalid notice, and as such, the notice was no notice at all, and for all practical purposes the position is that no notice under Sec. 23 (2) was issued to the assessee. It is, however, argued that although a valid notice under Sec. 23 (2) was necessary in the present case it is not a condition precedent to the making of an assessment under Sec. 23 (4), and it is said that an assessment under Section 23 (4) can be made in the present case because of a default in the compliance with the notice under Sec. 22 (4).

It is now well settled on the authorities of several High Courts in India that a notice under Sec. 22 (4) can be issued on the assessee at any stage and at any time and the only limitation that is fixed is that the assessee must have been served with a notice under Sec. 22 (2) : see the case of *Pallumal Bhola Nath, in re, Ramaswami Chettiar* v. *Commissioner of Income-tax, Muhammad Hayat Haji Muhammad Sardar* v. *Commissioner of Income-tax, Punjab, Harmukhrai Dulichand, in re*, and *Ram Khelawan Ugam Lal* v. *Commissioner of Income-tax*. Some of the above cases also lay down that a combined notice under Secs. 22 (4) and 23 (2) can be issued after an assessee has made a return, and it was held in the case of *Harmukhrai Dulichand* that where an assessee had made a return in compliance with a notice under Sec. 22 (2) and thereafter a notice has been served upon him under Sec. 23 (2) and also a notice under Sec. 22 (4) and the assessee has complied

with the terms of the notice under Sec. 23 (2) by producing the evidence upon which he relies, but has failed to comply with the notice under Sec. 22 (4) to produce account books, the Income-tax Officer is entitled to make an assessment under Sec. 23 (4) for failure to comply with the notice under Sec. 22 (4), and a somewhat similar view was held in the case reported in I. L. R. 52 Mad. page 194 (*Ramaswami Chettiyar's Case*). It is therefore, argued on behalf of the Department that the defaults mentioned in Sec. 23 (4) are independent defaults and any one of them would entitle the Income-tax Officer to make an assessment to the best of his judgment, and although in the present case the notice under Sec. 23 (2) may be held to be invalid or irregular there was a non-compliance with the notice under Sec. 22 (4) and the Income-tax Officer was entitled to proceed under Sec. 23 (4). It must, however be remembered that in the cases to which reference has been made the notice that was issued under Sec. 23 (2) was a valid and a legal notice and there was a compliance with the said notice, but there was a non-compliance with the notice under Sec. 23 (4) and therefore the Income-tax Officer could proceed under Sec. 23 (4). In the present case the contention on behalf of the assessee is that because the Income-tax Officer had reached the frame of mind when he had reason to believe that the return made under Sec. 22 was incorrect or incomplete, he was bound to issue a valid notice under Sec. 23 (2), and as this mandatory notice was not issued the officer could not proceed to make the best judgment assessment on failure of compliance with the notice under Sec. 22 (4), because if a valid notice had been issued under Sec. 23 (2) the assessee might have removed the suspicions of the Officer and might have satisfied him that his return was correct and complete, and it would be a great hardship if a best judgment assessment was made under Sec. 23 (4) because of a non-compliance with the notice to produce accounts when such accounts were in reality not necessary for the purpose of checking the return. There is some force in this contention and to a certain extent it is supported by a dictum of Rankin, C. J., in the case of *In the matter of Sadaram Puranchand*, where the learned Chief Justice at page 731 (of A.I.R. 1931 Cal.) observes :

"But I do not think that it was ever intended by the Act that failure to produce books prior to the filing of a return, should deprive the assessee of his right to have the return duly and properly inquired into. A return which by Sec. 22 is to be deemed to be a return made in due time cannot be treated as still born

because of a previous failure to comply with a notice under Sec. 22 (4)."

Reliance is also placed on the case of *Kajori Mal Kalyan Mal of Cawnpore*, where the assessee had not filed a return in pursuance of a notice under Sec. 22 (2) nor had submitted his account books in pursuance of a notice under Sec. 22 (4) and the Income-tax Officer had proceeded under the provisions of Sec. 23 (4) and an application under Sec. 27 of the Act was rejected by the Income-tax Officer and the Assistant Commissioner. A reference was then made to the High Court and the learned Judges held that it was open to the High Court to formulate questions of law that really arose in a case and to answer them for the benefit of the Commissioner and the parties, and the fresh question of law that was formulated by the High Court was to the following effect :—

"Was the assessee prevented by sufficient cause from making the return required by Sec. 22?"

The answer that was given was that under Sec. 22 (2) the Income-tax Officer must give the proposed assessee at least thirty days time within which to file a return. If this minimum is denied the notice becomes entirely illegal and no subsequent extension of time will cure the defect that initially lay in the notice issued. It will be observed that in this Allahabad case there was a non-compliance with a notice under Sec. 22 (4), but as the initial notice under Sec. 22 (2) was an irregular notice the learned Judges held that there could possibly be no valid assessment of income-tax under Sec. 23 (4). The phraseology of Sec. 23 (2) suggests that under the circumstances of the present case a valid notice under Sec. 23 (2) was imperative, but the phraseology of Sec. 23 (4) suggests that perhaps the Income-tax Officer could proceed to make a best judgment assessment because of the failure to comply with all the terms of a notice issued under Sec. 22 (4). Our answer to the second question is that although the issue of a valid notice under Sec. 23 (2) was not a condition precedent, under the circumstances of the present case to the making of an assessment under Sec. 23 (4) the issue of such a valid notice was imperative, and this opinion of ours will have a bearing on the answer to question No. 3.

Question No. 3 runs as follows :—

"If the issue of the above notice is a condition precedent, is an assessee justified in disobeying a notice under Sec. 22 (4) and can he be said to be prevented by sufficient cause from complying with the said notice?"

The meaning of the question is fairly clear, but in view of

our answer to the second question the third question might be reframed as follows :—

"Whether the issue of the above notice is a condition precedent under the circumstances of the present case to the making of an assessment under Sec. 23 (4) or not, was the assessee justified in disobeying a notice under Sec. 22 (4) and can he be said to have been prevented by sufficient cause under Sec. 27 from complying with the said notice?"

This necessitates an interpretation of Sec. 22 of the Act which for the purpose of the present case might be deemed to read as follows :—

"Where an assessee within one month from the service of a notice of demand issued as hereinafter provided satisfies the Income-tax Officer that he was prevented by sufficient cause from making the return required by Sec. 22, or that he did not receive the notice issued under sub-sec. (4) of Sec. 22, or sub-sec. (2) of Sec. 23, or that he had not a reasonable opportunity to comply, or was prevented by sufficient cause from complying with the terms of the last mentioned notices, the Income tax Officer shall cancel the assessment and proceed to make a fresh assessment in accordance with the provisions of Sec. 23."

It would thus appear that the assessee in order to succeed under Sec. 27 has got to establish any one of the following conditions :—

(1) he was prevented by sufficient cause from making the return required by Sec. 22,

(2) he did not receive the notice issued under sub-sec. 4 of Sec. 22,

(3) he did not receive the notice issued under sub-sec. 2 of Sec. 23,

(4) he had not a reasonable opportunity to comply with the terms of the last-mentioned notices, or

(5) he was prevented by sufficient cause from complying with the terms of the last-mentioned notices.

It is contended on behalf of the assessee that the notice issued under Sec. 23 (2) in the present case was an illegal notice and therefore it is tantamount to the non-receipt of such a notice and therefore he has established condition No. 3. There is some force in this contention and, as Sec. 27 reads it might be argued that on the establishment of any one of the conditions mentioned in Sec. 27, the Income tax Officer has to cancel the assessment and has to proceed to make a fresh assessment. The argument on be-

half of the Department, however, is that Sec. 27 is utilised by the assessee when there has been a best judgment assessment, and one has got to see as to what the default was which brought about the best judgment assessment and the assessee has got to satisfy that that default can be condoned either because the notice in connection with which the default was made was not received or that he had no reasonable opportunity to comply with that notice or that he was prevented by sufficient cause from complying with that notice. In the present case the default was in connection with the notice under Sec. 22 (4) and the assessee has therefore to satisfy that that notice was not received or that he had no reasonable opportunity to comply with that notice or that he was prevented by sufficient cause from complying with that notice. Although perhaps, according to the wording of the section, there is some force in the contention of the assessee, yet it is more reasonable to accede to the argument of the Department and to hold that the assessee must satisfy the conditions laid down in Sec. 27 in connection with that particular notice non-compliance with which brought about the best judgment assessment.

We have already held in connection with the preliminary objection raised by the learned Commissioner that a question of law can arise in a matter like this, and in the case reported in A.I.R. 1931 Cal. 729 (*Sadaram Puranchand, In re*) the learned Chief Justice after narrating the facts of the case observed:

"I am prepared to hold as a matter of law that he (the Income-tax Officer) did not give to the assessees such reasonable opportunity as the Act requires to produce their evidence in support of their return."

In the present case we have already held that the notice under Sec. 23 (2) was an illegal notice and we have also held that the Income-tax Officer was bound to issue a valid notice under Sec. 23 (2). It must therefore, be deemed that no notice under Sec. 23 (2) was issued to the assessee and to that extent the Income-tax Officer was in default. The assessee was also in default in having failed to comply with the terms of a notice under Sec. 22 (4), but he can very well say that as the imperative notice under Section 23 (2) was not issued to him, he could ignore the notice issued under Section 22 (4) and in that sense was prevented by sufficient cause from complying with that notice. Whether a valid notice under Sec. 23 (2) was a condition precedent or whether it was only imperative under the circumstances of the present case it is clear that the assessee was denied a valuable right and he was, therefore

prevented by sufficient cause from complying with the notice issued under Sec. 22 (4), and this is our answer to the third question.

A copy of our judgment will be sent to the learned Commissioner under the seal of the Court and the signature of the Registrar. The assessee is entitled to his costs as certified. Counsel for the Department is entitled to Rs. 500 as his fees. Six weeks are allowed him to file the certificate.

Reference answered.

[IN THE CALCUTTA HIGH COURT.]

AMRITA BAZAR PATRIKA, IN RE.

COSTELLO, A.C.J., PANCKRIDGE, J., and EDGLEY, J.

July 14, 1937.

BUSINESS EXPENDITURE—EXPENSE INCURRED BY NEWSPAPER COMPANY IN DEFENDING EDITOR AND PRINTER IN PROCEEDINGS FOR CONTEMPT OF COURT—WHETHER ALLOWABLE AS 'EXPENDITURE INCURRED FOR EARNING PROFITS'—INDIAN INCOME TAX ACT (XI of 1922), Sec. 10 (2) (ix).

The assessee was a limited company carrying on the business of editing, publishing and selling a newspaper. The Editor and the Printer and Publisher of the paper were prosecuted and convicted for contempt of Court in respect of an article published in the paper. The company met all the expenses in connection with the defence of these persons and other proceedings relating thereto and claimed that the expenditure thus incurred should be deducted under Section 10 (2) (ix) of the Income Tax Act in computing its assessable income. The contempt proceedings were against the Editor and the Printer, the expenditure was primarily incurred by them and there was no sort of legal obligation on the company to re-imburse them for the expenses they had incurred : Held, *on a reference by the Commissioner that the question was really one of fact and that in the facts and circumstances of the case the expenditure in question was not incurred 'for the purpose of earning profits or gains' and consequently was not allowable as a deduction under Sec. 10 (2) (ix) of the Act.*

For allowing a deduction under Sec. 10 (2) (ix) it is not enough that the disbursement is made in the course of, or arises out of, or is connected with the business, or is made out of the profits of the business. It must be incurred for the purpose of earning the profits.

QUAERE: *Whether the expenses could be treated as a business loss.*

Cases referred to:

COMMISSIONERS OF INLAND REVENUE *v.* ALEXANDER VON GLEHN & CO., LTD. [1920] (12 Tax Cas. 232; 1920, 2 K.B. 553; 89 L.J.K.B. 590; 123 L.T. 338).

STRONG & CO. LTD. *v.* WOODIFIELD [1906] (1906 A.C. 448; 5 Tax Cas. 215).

Case stated by the Commissioner of Income Tax, Bengal, under Section 66 (2) of the Indian Income Tax Act (XI of 1922) in the matter of the assessment of 'The Amrita Bazar Patrika Ltd.' for the assessment year 1936-37. [Ref. No. 3 of 1937.]

CASE.

"The assessee in this case asked me to refer to the Hon'ble High Court under Sec. 66 (2) of the Income tax Act, the following questions of law which according to it have arisen out of the Assistant Commissioner's orders in appeal relating to the assessment of the year 1936-37:—

(1) Is an item of law costs incurred by a journalist in defending a contempt of Court case which arose in the discharge of his duties as such journalist an admissible deduction as contemplated in the provisions of Sec. 10 (2) (ix) of the Act?

(2) Is such item of costs allowable in view of the circumstances of this case?

2. **Facts of the case.** The assessee is a limited company and its business is that of editing, publishing and selling the newspaper called 'The Amrita Bazar Patrika'. On the 23rd March 1935 it published in its daily Calcutta edition a leader with the caption "Calcutta High Court", the first paragraph being as below:—

"We are glad to find that in the Bengal Legislative Council yesterday there was discussion about administration of the Calcutta High Court. Every word of Mr. N. K. Basu was true...We wish the Chief Justice and the Judges appreciate the sentiments of the public. The generation that has gone by should be an ideal to them."

Thereupon on the 28th of March a rule was issued by the High Court, calling upon the editor and the printer and publisher of the Patrika to attend in person and show cause before the Court on the 5th April following why they should not be committed to law for contempt of Court alleged to have been committed by them in having unlawfully published the article set forth above. On the 5th April the matter was heard by a Special Bench of the High Court. These persons were found guilty and were convicted, the former getting three months' simple imprisonment and the latter, one month. The judgment was delivered on the 8th April 1935 (vide 39 C.W.N. 770). An application for leave to appeal to the Privy Council was made by the accused persons and the High Court having refused to grant such leave, unsuccessful attempts were made to have special leave of His Majesty in Council. The assessee met all the expenses, and claims that the sum of Rs. 5,577-7-9 was incurred as costs in defending the Contempt Case and in the proceeding with a view to appeal before the Privy Council. It claims that this should be allowed as a business expenditure in the assessment. The Income-tax Officer did not however agree with the assessee's contention, as according to him this expenditure did not come within the purview of Sec. 10 (2) (ix) of the Income-tax Act. The assessee in its appeal before the Assistant Commissioner claimed that the sum under discussion was incidental to the earning of profits as journalist and as such should have been allowed under the terms of Section 10 (2) (ix) of the Act. It was argued before the Assistant Commissioner of Income Tax that a newspaper is required to make fair comments and that transgression of the bounds of fair comments in the case of the assessee was incidental to its business of publication of news. The Assistant Commissioner however did not accept this argument, for he did not think contempt of Court to be necessarily a legitimate incident in the conduct of the business of a newspaper.

3. The assessee has urged before me that a newspaper has two functions; one is selling news and the second is that of a guide and adviser, seeking to form the opinion and influence the action of the public. For this second aspect, some privilege is extended to the publication of fair and true reports of political, judicial, legislative and other public and official proceedings and that comment on or criticism of the acts of persons before the public should be treated as privileged if they are made in a fair and reasonable spirit and not actuated by malice. It has also been urged that a newspaper has to publish materials gathered from every quarter

of the world and report them with as little delay as possible in the paper and that therefore it cannot be considered to be infallible. In publishing news it takes some hazard and the vital point which is urged before me is that the hazards of the business of a newpaper like those of any other must be borne by the business itself. What, however, I am concerned with is whether the sum of Rs. 5,577-7-9 is an admissible deduction under Sec. 10 (2) (ix) of the Income-tax Act. The present assessment is for the year 1936-37 and is in respect of the income, profits or gains of the year ended 31st December 1935. The expenditure in question was incurred by the assessee during this latter year. The whole question is whether in computing the profits or gains of the business carried on by the assessee during the year ended 31st December 1935 an allowance can be claimed in respect of the above expenditure under Sec. 10 (2) (ix) of the Income Tax Act.

4. In view of the circumstances stated above, the question which, in my opinion, arises is :—

"Whether in the facts and circumstances of the case as set forth above, the sum of Rs. 5,577 spent by the assessee during the year ended 31st December 1935, to meet the litigation expenses as stated above, can be said to be 'expenditure incurred solely for the purpose of earning the profits' within the meaning of Sec. 10 (2) (ix) of the Indian Income tax Act (Act XI of 1922) and consequently allowable as a deduction in computing the profits or gains of the business for the assessment year 1936-37".

Instead of referring the question formulated by the assessee I, therefore, respectfully submit this question for the decision of their Lordships.

5. **Opinion of the Commissioner :—**

Sec. 10 (2) (ix) reads as below :

Any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains should be allowed as a deduction in computing the profits or gains.

The expenditure was incurred not with the object of earning the profits as will be clear from what has been stated above. There was a contempt proceeding against the Editor and the Printer of the assessee company and some expenditure was incurred in defence, and on conviction, attempt was made to file an appeal before the Privy Council which proved unsuccessful. The assessee company was not bound to incur this expenditure. The Editor and the Printer and Publisher were charged with having committed some criminal offence and if the company chose to meet

the expenses for defending them in the prosecution that followed, such expenditure cannot in my opinion, be said to be incurred solely for the purpose of earning the profits of the business. It is hardly permissible to infer that the assessee gave its servants authority to commit the crimes: nor in my opinion is it permissible to assume that commission of such crimes is necessary for or incidental to the carrying out of the business of the assessee and when the assessee incurred this expenditure in defending its servants it did not do so for the purpose of earning any profit. Expenditure incurred in cases like this cannot, in my opinion, be treated as business expenses. The decision in 12 Tax Cas. 227 (*Commissioners of Inland Revenue* v. *E. C. Warnes & Co. Ltd.*) and 12 Tax Cas. 232 (*Commissioners of Inland Revenue* v. *Alexander Von Glehn & Co., Ltd.*) are somewhat apposite. In those two cases, a fine in respect of a breach of law or in respect of a statutory order was held to be not a loss connected with or arising out of a trade or connected with the business. The principle underlying these decisions would, in my respectful opinion, equally apply to the present case. I, therefore, respectfully submit that their Lordships would be pleased to hold that the sum under discussion was not incurred solely for the purpose of earning the profits or gains of the relating accounting year which is the year ended 31st December 1935.

6. I append to the Statement of Case copies of the following documents:—A. Assessment Order. B. Grounds of Appeal. C. Appeal Order. D. Application under Sec. 66 (2)."

JUDGMENT.

COSTELLO, A.C.J.—This is a reference under Sec. 66 (2) of the Indian Income tax Act of 1922. The question for the consideration of the Court is set forth in paragraph 4 of the Statement of this Case in the form :—

"Whether in the facts and circumstances of the case, the sum of Rs. 5,577 spent by the assessee during the year ended 31st December 1935, to meet the litigation expenses can be said to be 'expenditure incurred solely for the purpose of earning the profits' within the meaning of Sec. 10 (2) (ix) of the Indian Income Tax Act (XI of 1922) and consequently allowable as a deduction in computing the profits or gains of the business for the assessment year 1936-37."

The facts of the case were these. The assessee is the Limited Company known as the Amrita Bazar Patrika Ltd., and its business is that of editing, publishing and selling a paper called 'The

Amrita Bazar Patrika'. On the 23rd March 1935, it published in its daily edition in Calcutta a leader with the caption "Calcutta High Court" and in that leader certain observations were made which reflected upon the independence of judiciary.

On the 29th March 1935 a Rule was issued by this Court calling upon the Editor and the Printer and Publisher of the *Patrika* to show cause before the Court on the 5th April following, why they should not be committed to jail for contempt of Court in having unlawfully published the article I have mentioned. The matter came before a Special Bench of this Court on the 5th April 1935. The judgment of the Court was declared on the 8th April. The Editor and the Printer of the newspaper were found guilty of contempt of Court, the former being sentenced to 3 months' simple imprisonment and the latter to one month's simple imprisonment. Subsequently, there was an application for leave to appeal to the Privy Council which was rejected by this Court and later attempts were made to obtain special leave from the Judicial Committee of the Privy Council to appeal to His Majesty in Council. These attempts were also unsuccessful. It appears that the newspaper or rather the limited company, the Amrita Bazar Patrika Limited, met all the expenses in connection with the proceedings that is say, the costs of defending the Editor and the Printer before this Court and the various other proceedings in connection with the matter. These expenses amounted to the sum of Rs. 5,577-7-9 pies which is the sum mentioned in the question put forward for our consideration. The company claimed that this sum ought to be allowed by the Income-tax Officer as a business expenditure, in other words, that it was an expenditure of the kind contemplated by Sec. 10 (2) (ix) of the Income Tax Act. Sec. 10 (1) of the Income Tax Act says that "tax shall be payable by an assessee under the head "Business" in respect of the profits or gains of any business carried on by him". Sub-sec. (2) says that such profits or gains shall be computed after making certain allowances. Then follow a catalogue of allowances, No. (ix) of which is described thus:—" any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains."

The assessee urged before the Commissioner of Income Tax that a newspaper has two functions—one, the conveying of news, and the other, that of serving as a guide and adviser seeking to form opinion and to influence the action of the public. As regards the second aspect, it is suggested that some privilege is extended to

the publication of fair and accurate reports of political, judicial, legislative and other public and official proceedings and that comment on, or criticism of, the acts of persons before the public should be treated as privileged if they are made in a fair and reasonable spirit and not actuated by malice. It was further contended that a newspaper has to publish materials gathered from all parts of the world and that, therefore, it cannot be considered or treated as if it were infallible. In publishing news it is bound to take some risk and the risk attendant to the business of publishing a newspaper must be borne by the business itself. The learned Commissioner of Income Tax took the view, however—in our opinion, rightly—that what he was concerned with was the precise language of Sec. 10 (2) (ix) and that all he had to decide was whether or not the sum of Rs. 5,577-7-9 pies was a deduction of the kind referred to in sub-clause (ix). The Commissioner points out that the assessment was for the year 1936-37, and it was in respect of the income, profits or gains of the year ending 31st December 1935. The expenditure in respect of the contempt matter was incurred by the limited company during the year 1935 and, therefore, the whole question to be determined was whether in computing the profits or gains of the business carried on by the assessee during the year ended 31st December 1935, an allowance could be claimed in respect of that expenditure under the provisions of Sec. 10 (2) (ix).

The question which we have to answer is simply this: Can it be said that the expenditure which the limited company chose to incur was an expenditure incurred solely for the purpose of earning profits or gains?

In our opinion, the question almost answers itself. It is difficult, indeed, to see by what process of reasoning it could really be argued that this particular expenditure was incurred for the purpose of earning profits or gains. It is to be remembered that the proceedings in contempt were against the Editor and the Printer. The expenditure primarily was incurred by them. As far as we know, there was no sort of obligation of the Limited Company to reimburse either the Editor or the Printer for the expenses they had incurred. In any event, it seems quite obvious that the payment of this sum of Rs. 5,577-7-9 pies in no way assisted the limited company in earning profits or acquiring gains in the year of assessment. The question, in our opinion, is really one of fact. Analogous points have been dealt with in England upon that footing. In our view, the matter is covered by the judgment of the House

of Lords in the cases of *Strong & Co. of Romsey, Limited* v. *Woodifield*, [(1906) A.C. 448] and, in particular, by the opinions expressed in the speech of the LORD CHANCELLOR at 452 and that of LORD DAVEY at p. 453. The LORD CHANCELLOR said this :—

"In my opinion, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction ; for it may be only remotely connected with the trade, or it may be connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with the trade in the sense that they are really incidental to the trade itself. In the previous paragraph he said—"A deduction cannot be allowed on account of loss not connected with or arising out of such trade. That is one indication. And no sum can be deducted unless it be money wholly and exclusively laid out or expended for the purpose of such trade. That is another indication."

LORD DAVEY said : "It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits. In short I agree with the judgment of the Master of the Rolls."

The learned Commissioner has referred to the case of *Commissioners of Inland Revenue* v. *Alexander Von Glehn & Co. Ltd.*, (12 Tax Cas. 232). In that case the Respondent company had carried on business as general produce merchants and exported goods to Russia and Scandinavia. It was sued for penalties under the Customs Act, 1915, in respect of alleged infringements of that Act in the course of its trade. The actions were settled by consent on the company agreeing to pay a compromise penalty of £3,000 without costs upon terms that the record was withdrawn. The company incurred legal costs amounting to £1,074-12-7 d. in respect of the proceedings. It was held by the Court of Appeal that the mitigated penalty and costs were not admissible deductions in arriving at the profits of the company's trade for Excess Profits Duty purposes. The Master of the Rolls, LORD STERNDALE, said this (at the top of p. 236) : "The money which is paid is money paid as a penalty, and it does not matter in the least that the Attorney-General has elected to take treble the value of the goods, nor does it matter that it may be called in the information a forfeiture. It is in fact, under the section, a penalty". At p. 238, he said :—"Now, what is the position here? This business could perfectly well be carried on without any infraction of the law at

all. This penalty was imposed because of an infraction of the law and that does not seem to me to be, any more than the expense which had to be paid in the case of *Strong & Co.* v. *Woodifield* appeared to Lord Davey, to be a disbursement or expense which was laid out or expended for the purpose of such trade, manufacture, adventure or concern; nor does it seem to me, though this is rather more questionable, to be a sum paid on account of a loss connected with or arising out of such trade, manufacture, adventure or concern".

In the present instance, however, we are not concerned with the question as to whether the expenses incurred by the company might have been treated as a business loss. We are concerned only with the question whether the expenditure was one properly incurred for the purpose of earning profits or gains. We are clearly and definitely of opinion that it was not. The question propounded for our consideration must, therefore, be answered in the negative. The assessees will pay the costs of this reference, on the usual scale, including the fees of two Advocates appearing on behalf of Commissioner of Income Tax.

Panckridge, J.:—I only desire to add a few words to the judgment which has just been delivered. I agree that, in the circumstances, the question propounded by the Commissioner is a question of fact, and we are not entitled to go behind his finding.

Moreover, in my judgment, there were no materials before the Commissioner upon which he could possibly come to the conclusion that the expenditure was, in fact, incurred solely for the purpose of earning profits or gains. I must assume that the expenditure was sanctioned by some resolution of the Directors, but no extract from the Directors' Minute Book is before us, nor is there any statement by a Director of the Assessee Company.

In the grounds of appeal, filed before the Assistant Commissioner it is stated that the expenditure was incidental to the earning of the assessee's profits as a journalist.

In a petition filed by the principal officer of the assessee company it is stated that the expenses incurred were incidental to the profession of journalism and were legitimate business expenses allowable under Sec. 10 (2) (ix) of the Act.

There is, therefore, no direct statement by any one who is in a position to speak with authority on the subject that the purpose for which the expenditure was sanctioned was in order that the

profits and gains of the assessee company might be augmented thereby.

It appears to me that this could not have been the purpose which the directors entertained when they sanctioned the expenditure. I have no doubt that the Directors considered it a moral obligation to indemnify their editor against the expenses to which he was put in defending the contempt proceedings, because the contempt with which he was charged was committed in his capacity as Editor of the newspaper owned by the assessee company. Their motive is a perfectly intelligible one, but it has not the effect of making the expenditure a permissible deduction under Sec. 10 and it is totally inconsistent with such expenditure being expenditure incurred solely for the purpose of earning profits and gains within the meaning of Sec. 10 (2) (ix).

EDGLEY, J.—I agree with my Lord the Acting Chief Justice.

Reference answered in the negative.

[IN THE RANGOON HIGH COURT.]

COMMISSIONER OF INCOME-TAX, BURMA

v.

HAJEE MOHAMED HAJEE OOSMAN.

ROBERTS, C.J., LEACH and MACKNEY, JJ.

March 17, 1937.

NON-RESIDENT—KEEPING OFFICE AT RANGOON FOR PURCHASING RICE—SALE OF RICE AT COLOMBO—PROFITS MADE AT COLOMBO, WHETHER ASSESSABLE AT RANGOON—' BUSINESS CONNECTION '—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 42 (1).

The assessee who resided at Kathiawar (outside British India) carried on the business of selling rice in Colombo. Part of the rice sold by the assessee in Colombo was purchased by him or his agent at an office kept on his behalf at Rangoon and then exported to Colombo for resale: Held, *on a reference by the Commissioner, that the assessee's profits made in Ceylon on the sale of rice purchased in Burma were assessable under Sec. 42 (1) of the Indian Income Tax Act, 1922.*

Case stated by the Commissioner of Income Tax, Burma, under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922 [Civil Ref. No. 1 of 1937].

CASE

The following case is referred to the High Court in accordance with the provisions of Sec. 66 (2) of the Indian Income-tax Act, 1922.

1. Hajee Mohamed Hajee Oosman (hereinafter called "the assessee"), a resident of Dhoraji in Kathiawar, outside British India, carries on a business in rice in Burma and Ceylon. The rice is purchased in Rangoon and exported to Colombo where it is sold. The assessee maintains an office in Rangoon where accounts are kept for the transactions effected there and another office at Colombo which keeps accounts for the transactions effected there and for the business as a whole.

2. For his 1935-36 assessment the assessee returned a loss of Rs. 253-8-9. This was the figure appearing in his Rangoon books. After adding back certain disallowable items and certain items of profit amountidg to Rs. 10,698 transferred to the Colombo books, the Income-tax Officer arrived at an assessment figure of Rs. 10,935. A copy of his assessment order is attached as Annexure A.

3. Against this assessment the assessee appealed. In dealing with the appeal the Assistant Commissioner called upon the assessee, under Sec. 31 (3) (*a*) of the Act [*vide* proviso to Sec. 31 (3)] to show cause why the assessment should not be enhanced by including, under Sec. 42 (1) of the Act, the profits arising from the sale of the rice in Colombo. Having heard the assessee's advocate the Assistant Commissioner enhanced the assessment to Rs. 22,427 by including the Colombo profits. A copy of the appellate order is attached as Annexure B.

4. The assessee appealed to the Commissioner under Sec. 32 against this decision. Having heard the assessee's advocate I rejected the appeal. A copy of my order is attached as Annexure C. Being dissatisfied with this order the assessee has asked me to state a case to the High Court. I accordingly refer the following question :—

"Whether in the circumstances of this case the assessee's profits made in Ceylon on the sale of rice purchased in Burma are assessable under Sec. 42 (1) of the Indian Income Tax Act, 1922.

5. Profits, in order to be assessable under Sec. 42 (1), must (*a*) be the profits of a non-resident and (*b*) accrue to him whether directly or indirectly, through or from any business connection or property in British India. As to (*a*) there is no dispute. And as

to (*b*) the contention of this Department is that the profits in question accrued to the assessee from a business connection in British India. Whether the profits did so accrue is the only point for decision.

6. I have already gone over the ground in my appellate order (Annexure C) and I need not repeat myself here*.

I would express my opinion shortly by saying that this case appears to me not different in essentials from *Steel Brothers Case* (2 I.T.C. 119). And as to the meaning of the decisions in that case and in the *Rogers Pratt Shellac Case* (1 I.T.C. 363) I would refer to the observations of Beaumont, C. J. (at page 433) and Rangnekar, J. (at page 438) in the case of the *National Mutual Association of Australasia, Ltd.* (6 I.T.C. 426).

7. I would therefore answer the question in the affirmative.

*The appellate order referred to here in which the Commissioner has expressed his opinion in detail runs as follows:

"1. The assessee, a non-resident, carries on a business in rice in Burma and Ceylon. He has an office in Rangoon for the purchase of rice. The rice purchased is exported to Colombo where it is sold. Another office is maintained in Colombo for the sale of rice. Accounts are kept at each office for the transactions effected there. The results of the business as a whole are incorporated in the Colombo accounts.

2. The Income-tax Officer made the assessee's 1935-36 assessment on Rs. 10,935 which he computed as the profits of the Rangoon business. When the assessee appealed against this assessment the Assistant Commissioner called upon him to show cause why the assessment should not be increased to Rs. 24,918 by adding to it, in accordance with the provisions of Sec. 42 (1) of the Income-tax Act, Rs. 13,983 being profits made by the sale of the rice in Colombo. Having heard the assessee's advocate, the Assistant Commissioner enhanced the assessment to Rs. 22,427 by including the Colombo profits. This is an appeal against that enhancement.

3. The first and main question to be decided is whether the profits made on sales of rice in Colombo come within the terms of Sec. 42 (1). In order to come within the terms of that sub-section they must have accrued or arisen to the assessee directly or indirectly through or from a business connection in British India. The deciding factor in the matter is the existence of a business connection through or from which the profits arise. There is no

authoritative definition of the expression "business connection" but what it means can be ascertained fairly accurately from the decided cases.

4. In the *Rogers Pratt Shellac Company's Case* (1 I.T.C. 363) it was held that a business connection existed when a purchasing branch in India sent goods to the principals outside India to be sold abroad. Following that, the Rangoon High Court in *Steel Brothers Case* (2 I.T.C. 119) held that a business connection existed in somewhat similar circumstances. But in giving its decision the Court expressed the opinion that the meaning of "business connection" should be restricted by the definition of "business" in Section 2 (4) of the Act. The passage in question (page 137) is as follows:—

"We admit the difficulty arising from the vague expression 'from any business connection.' Taken in its wide sense, it would render liable to Indian income-tax any profits made by a manufacturer in England on a single consignment of goods to an importer in India. This is the meaning which the Commissioner of Income Tax seems to have attached to the phrase, and is the meaning which, the learned Government Advocate contends, is the correct one. It is one, however, which we cannot adopt, as such a meaning would be repugnant to the word 'business' in Sec. 6, as defined by Sec. 2 (4), and we can assign no wider meaning to it than the latter words of the definition as 'any adventure or concern in the nature of trade, commerce or manufacture.' It was probably used, as Mr. Justice Chatterjee conjectures, as a compendious expression to cover such concerns in the nature of trade, commerce, or manufacture as arise through a branch factorship, agency, receivership or management. But be this as it may, its meaning, in our opinion, must be strictly confined to the meaning of the word 'business' in Section 6."

5. This view of the Rangoon High Court has been dissented from by the Bombay High Court in the *National Mutual Association Case* (6 I.T.C. 426) and by the Privy Council in *Currimbhoy's Case*, Privy Council Appeal No. 104 of 1934. In that case their Lordships said, "It was contended on behalf of the respondents that the words 'business connection' and 'property' in Sec. 42 (1) are intended as repetitions of the expressions 'business' and 'property' appearing in Sec. 6 to describe 'heads of income,' and that the interest income now in question, being admittedly taxable under the 7th heading 'other sources' cannot be said to accrue or arise through or from any business connection or pro-

perty in British India within the meaning of the sub-section. In support of this argument their Lordships were referred to certain observations in the case of *Rogers Pratt Shellac & Co.* v. *Secretary of State for India* (I.L.R. 52 Cal. 1) and *Commissioner of Income-tax, Burma* v. *Messrs. Steel Brothers & Co., Ltd.* (1925, I.L.R. 3 Ran. 614). This contention, however, does not appear to their Lordships to be valid. The phrase 'business connection' is different from, though doubtless not unrelated, to the word 'business' of which there is a definition in the Act".

6. It may be taken therefore that the words 'business connection' embrace a much wider field than the word business as defined in Sec. 2 (4) of the Act. The case of the National Mutual Association referred to above is a case in point. There the insurance company was not carrying on "any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture," yet it was held that interest earned by the company outside British India on insurance premiums collected in British India was income which accrued through a business connection in British India. Comparing it with the *Rogers Pratt Shellac Case* and with *Steel Brothers Case*, Beaumont, C. J., said, "I do not myself see any distinction in principle between the case of goods acquired in British India by an agent in British India and sent to the principal resident outside British India, and there sold at a profit and the case of moneys collected by an agent in British India and sent to the principal outside British India and there invested by him at a profit".

7. *The Currimbhoy's Case* (6 I.T.C. 439 and Privy Council Appeal No. 104 of 1934) is a case where it was held that a "business connection" did not exist. In this case there was a solitary loan made outside British India by the Nizam of Hyderabad to Messrs. Currimbhoy Ibrahim and Sons Limited, a company doing business in Bombay. Beaumont, C. J., said: "The business connection must be one of the person residing out of British India, that is, the Nizam, and there is nothing to show that the Nizam is carrying on the business of money-lending." He held that the relationship of the parties was merely *that of debtor and creditor*. The Privy Council upheld that decision. I quote the following from their Lordships' Judgment:—

"Upon the question whether the interest income arose to the Nizam through or from any business connection in British India the Lordships observe that so far as appears from the facts found in the Letter of Reference, the loan made by the Nizam to the

respondent company on the 10th August, 1929, was an isolated transaction between the parties. It is not shown that the Nizam has at any time had an interest direct or indirect in the respondent company. There is no evidence of a course of dealing between the parties such as might fairly be described as a business connection previously subsisting between them. There is no element in the present case which justifies a comparison on the facts with the position of the parties in the case of *The Bombay Trust Corporation* [(1928) I.L.R. 52 B. 702; 57 I.A. 49].

"If the words 'accruing or arising to such person whether directly or indirectly, through or from any business connection in British India' are not to be deemed satisfied in every case in which a single monetary transaction by a non-resident with a resident produces gain to the former, it is difficult to see in the facts of this case any distinguishing element of business connection which the Legislature has chosen as the test for rendering chargeable to British Indian income-tax income which has not accrued, in British India. There is no proof that the Nizam is carrying on business of money-lending either in Hyderabad or British India. So far as appears he invested some surplus capital in making a loan to the respondent company taking security therefor. That the respondent company doubtless used the borrowed money in connection with their own business is not a fact which brings the Nizam any nearer to being a person who has a business connection in British India. The circumstances that the repayments of the loan are contemplated to extend over a period of five years, and that the interest would be payable from time to time during this period, is equally ineffective to bring the case within the words of sub-Sec. (1) of Section 42".

8. The following inferences can I think be drawn from the judgment in the *Currimbhoy's Case*:—

(*a*) If the Nizam had had several transactions with the Currimbhoys the Courts would have been prepared to hold that there was a business connection between them.

(*b*) If the Nizam had had a money-lending business, either within or without British India, the Courts would have been prepared to hold that this single transaction between him and the Currimbhoys constituted a "business connection".

9. Coming now to the present appeal, the assessee's advocate tries to distinguish it from the *Rogers Pratt Shellac Case* and *Steel Brothers Case* on the ground that in those cases there were manufacturing activities in British India while the assessee merely has a

purchasing agency in British India. This objection misses the point of both these decisions which were not affected at all by the manufacturing activities of the companies concerned. In *National Mutual Association Case* (6 I.T.C. 425) Beaumont, C.J., referring to those cases says (page 433): " It was held by the Full Bench of the Calcutta High Court in *Rogers Pratt Shellac Company* v. *The Secretary of State* and by the Full Bench of the Rangoon High Court in *Steel Brothers and Co. Ltd.* v. *Commissioner of Income-tax, Burma,* that a company resident outside British India which received goods from branches within British India was assessable to Indian income-tax in respect of the profits made by the sale of these goods outside British India." And in the same case Rangnekar, J., referring to the *Rogers Pratt Shellac* judgment said, " In the Calcutta case to which I have referred, it was held that there was a business connection although all that happened was that goods were purchased in India by an agent and sent to the principals outside India and there sold at a profit ". And this description exactly fits the case of the assessee now before me.

10. It is unnecessary to labour the point any further. The profits in question are clearly liable to taxation under Sec. 42 (1) and therefore the appeal fails on the main ground. It only remains for me to consider whether they were properly computed. It appears to me that they were and that the assessee got the full benefit of the ruling in *Steel Brothers Case.*

11. The appeal is therefore rejected.

Kalyanwala, for the Assessee.

Tun Byu, for the Crown.

JUDGMENT.

ROBERTS, C. J.—In this case the Commissioner of Income-tax has referred to the High Court in accordance with the provisions of Sec. 66 (2) of the Indian Income-tax Act (XI of 1922) the following question :

" Whether in the circumstances of this case the assessee's profits made in Ceylon on the sale of rice purchased in Burma are assessable under Sec. 42 (1) of the Indian Income-tax Act, 1922 ".

The facts of the case may be stated very shortly. The assessee, one Hajee Mohamed Hajee Oosman, lives in Kathiawar, outside British India, and he carries on a business in Colombo where rice is sold and where he makes a profit. Part of the rice so sold in his business in Colombo is purchased by him or by his agent at an office kept on his behalf at Rangoon where purchases

of rice from time to time are made and the rice exported to Colombo for the purpose of re-sale. In these circumstances it is conceded by the learned advocate for the assessee—and he could have obviously taken no other course than do so—that the appellant maintained a business connection in British India, and the short point which we are asked is whether his profits made in Ceylon on the sale of rice purchased in Burma are assessable under Sec. 42 (1) of the Act. Looking at the section and sub-section it is manifest that in the case of the assessee who resides out of British India all profits or gains accruing to him, even indirectly, through his business connection in Burma must be deemed to be income arising within British India and chargeable to income-tax as such, and I would therefore answer the question propounded in the affirmative.

LEACH, J.—I agree.

MACKNEY, J.—I agree.

Reference answered in the affirmative.

[IN THE RANGOON HIGH COURT.]

COMMISSIONER ON INCOME TAX, BURMA

v.

S. MANSOOKHLAL ZAVERI.

ROBERTS, C. J., SEN, MOSLEY, LEACH, DUNKLEY MACKNEY and BRAUND, JJ.

January 20, 1937.

SUCCESSION TO BUSINESS—DISSOLUTION OF PARTNERSHIP—QUONDAM PARTNER CARRYING ON SAME BUSINESS—WHETHER 'SUCCESSION' TO DISSOLVED FIRM—WHAT CONSTITUTES 'SUCCESSION'—SUCCESSION TO PART OF BUSINESS—TESTS OF CONTINUITY OF BUSINESS—REFERENCE—QUESTION OF SUCCESSION, WHETHER QUESTION OF FACT OR LAW—INDIAN INCOME TAX ACT (XI of 1922), SECS. 26 (2), 25 (3), 66.

It is always open to an assessee who desires to argue the legal consequence of the facts to require a reference as to whether the Commissioner has attributed in law the correct legal consequence of the facts he has found.

Whenever the facts found by the Commissioner give rise to consequential question, whether there is or is not a 'succession' within

the meaning of Sec. 26 (2) of the Indian Income tax Act, 1922, a question of law is involved. The view that the question of succession must always be a pure question of fact is not correct.

A firm consisting of two partners, the assessee and his step-brother, got into financial difficulties and was dissolved on October 28, 1935. The assessee's step-brother executed a deed of release on February 28, 1936, by which he surrendered his right to the stock-in-trade and furniture of the firm and to the use and occupation of the business premises. He further gave up all claims to the outstandings and also assigned to the assessee his right to the trade marks of the firm. Before the dissolution certain major creditors, but not all, were paid off but, apart from this, the assessee took over the assets and liabilities of the firm. The assessee carried on the same kind of business in the same premises though on a smaller scale. The name of the business was however slightly changed. The Commissioner found that the assessee had 'succeeded' to the business of the old firm and assessed him under Sec. 26 (2): Held, *on a reference by the Commissioner, (i) that the question whether on these facts the firm which was carrying on the business had been "succeeded in such capacity" by the assessee within the meaning of Sec. 26 (2) of the Indian Income-tax Act, 1922, was a question of law; (ii) that on the facts stated the question was rightly answered by the Commissioner in the affirmative.*

Per ROBERTS, C. J.—*The observation made by Page, C. J., in the case of* N. N. Firm *(11 Rang. 501) that where a business is split up and thereafter another person carries on business he does not 'succeed' his predecessor in carrying on the business within Sec. 26 (2) is only another way of saying that where a person has carried on a business no one can be said to succeed him in such capacity when only part of the business is taken over. It cannot, however, be laid down as an invariable proposition of law that when one business has come to an end and after a time another business is started with the same assets and in the same premises, there is no succession. The question in such cases comes to this,* viz., *whether there is a delay which as a matter of law the Commissioner is bound to regard as forcing him to infer that there was not a succession. This delay is a question of degree and in some cases the delay may only mean a cessor of profit-making operations and never a real cessation of the business. The real test is the identity of the two businesses, and when this comes to be considered the reasons for any delay may throw light upon the correct solution.*

Per MOSLEY, J.—*Succession to a separate branch of a business*

constitutes succession and the Indian rule is for this purpose identical with the English.

Commissioner of Income Tax, Burma v. *N. N. Firm*, (1934 I.T.R. 185) *commented upon.*

Cases referred to :

BELL *v.* NATIONAL PROVINCIAL BANK OF ENGLAND, [1904] (1904, 1.K.B. 149; 5 Tax Cas. 1; 90 L.T. 2; 73 L.J.K.B. 142; 20 T.L.R. 97).

COMMISSIONER OF INCOME TAX, BURMA *v.* N. N. FIRM [1934] (I.L.R. 11 Rang. 501; 148 I.C. 594; A.I.R. 1934 Rang. 13; 1934 I.T.R. 185).

COMMISSIONER OF INCOME TAX, BURMA *v.* C.P.L.E. CHETTYAR FIRM [1934] (I.L.R. 12 Rang. 322; 150 I.C. 408; A.I.R. 1934 Rang. 132; 1934 I.T.R. 201).

COMMISSIONER OF INCOME TAX, BURMA *v.* E. M. CHETTIAR FIRM [1930] (I.L.R. 7 Rang. 635; 122 I.C. 898; A.I.R. 1930 Rang. 4; 4 I.T.C. 111).

DHANNA MAL *v.* MOTI SAGAR [1927] (I.L.R. 8 Lah. 573; 101 I.C. 355; 54 I.A. 178; A.I.R. 1927 P.C. 102).

NAFAR CHANDRA PAL *v.* SHUKUR SHEIK [1918] (I.L.R. 46 Cal. 189; 45 I.A. 183; 51 I.C. 760).

NEW ZEALAND SHIPPING CO. LTD. *v.* STEVENS [1905] (5 Tax Cas. 553; 96 L.T. 50; 23 T.L.R. 213; 24 T.L.R. 172).

STOCKHAM *v.* WALLASEY URBAN DISTRICT COUNCIL [1907] (95 L.T. 834; 71 J.P. 244).

THOMSON & BALFOUR *v.* LE PAGE [1924] (8 Tax Cas. 541; 1924 Sess. Cas. 27; 51 Sc. L.R. 35).

WILD (H. M. INSPECTOR OF TAXES) *v.* MADAM TUSSAUD'S LTD. [1932] (17 Tax Cas. 127).

Case stated by the Commissioner of Income-tax, Burma, under Sec. 66 (2) of the Indian Income-tax Act (XI of 1922), in the matter of the assessment of Saralal Mansookhlal Zaveri for the assessment year 1936-37 [Civil Ref. No. 17 of 1936].

CASE.

" The following case is stated to the High Court in accordance with the provisions of Sec. 66 (2) of the Indian Income-tax Act, 1922.

2. The relevant facts of the case are as follows :—

(*a*) For some years past the firm of Mansookhlal Dolatchand & Co., has been carrying on business as jewellers and diamond merchants at No. 128, Mogul Street, Rangoon. Before moving to

No. 128, Mogul Street, the firm carried on business first in 26th Street and later at old No. 7, Mogul Street.

(*b*) This firm, which latterly consisted of two partners, Saralal Mansookhlal Zaveri (hereinafter called the assessee) and his step-brother Jeshanglal Mansookhlal Zaveri, got into financial difficulties and was dissolved on the 28th October 1935. (Originally the firm consisted of five partners. The assessee joined it about four years before its dissolution.)

(*c*) In a deed of release executed on the 28th February 1936 Jeshanglal surrendered his rights to any of the stock-in-trade and furniture of the firm and to the use and occupation of the Mogul Street shop. He further gave up all claims to the outstandings due to the firm and appointed the assessee to collect and receive them. He also assigned to the assessee his right to the trade marks of the firm. A copy of the deed is attached as Annexure A.

(*d*) Before the dissolution of the partnership certain creditors who were owed about Rs. 93,000 were paid in goods. Apart from these transactions the assessee took over the assets and liabilities of the firm. He took over stock worth Rs. 8,682 and other assets worth Rs. 2,604 and he took over liabilities amounting to Rs. 11,729.

(*e*) The assessee carried on the same kind of business as before in the same premises. In fact the shop was never closed and business was carried on in it continuously notwithstanding the dissolution of the partnership.

(*f*) The name of the business was changed from Mansookhlal Dolatchand & Co. to Saralal Mansookhlal.

(*g*) The dissolution of the firm took place at the end of the accounting year. Assessee took over the account books of the firm but he opened new books for the business for the new accounting year.

3. On the 7th April 1936 the assessee on behalf of Mansookhlal Dolatchand & Co. applied for the benefit of Section 25 (3) of the Income-tax Act on the ground that the business had been discontinued. The Income-tax Officer rejected the application and made an assessment on the assessee as the successor to the business [Section 26 (2)]. A copy of the assessment order is attached as Annexure B. The appeal against the assessment was rejected. A copy of the appellate order is attached as Annexure C. Being dissatisfied with this order the assessee has asked me to state a case to the High Court. I accordingly refer the following question :—

"Whether there were materials on which the Income-tax Officer and the Assistant Commissioner could conclude that the assessee had succeeded to the business carried on by Mansookhlal Dolatchand & Co. at 128, Mogul Street, Rangoon?"

4. The assessee's case is that he did not take over the whole of the business as a going concern, that in a business of this kind credit is the most important factor and that by changing the name of the business he has lost the credit attached to the old name. He also says that the extent of the business has been greatly curtailed. And the trade marks taken over had not been used by the firm for some years past and have not been used by the assessee.

5. It appears to me that the assessee did take over the business as a going concern. The settlements with creditors, which took place before the dissolution of the partnership, do not appear to me to be anything more than a preparation for the dissolution necessitated by the financial difficulties in which the firm found itself. And these difficulties would have caused a contraction of the business in any case. As to the change of name, it appears to have been a necessary consequence of the dissolution. There is no evidence before me to show that the old name was worth anything in the way of credit. It is equally probable that the assessee's personal credit is as good as that of the firm.

6. The choice is between finding that the assessee has started a new business or that he has continued the old business. It does not appear to me that he has started a new business. I think that there is ample material for the Income-tax Officer's decision that the assessee has succeeded to the business of the firm and that it should not be disturbed. I would therefore answer the question referred in the affirmative.

7. The following cases may be referred to:—

Watson Brothers *v.* Lothian ...	4 T.C. 441
Bell *v.* The National Provincial Bank of England, Ltd. ...	5 T.C. 1.
The Fullwood Foundry Co., Ltd. *v.* Commissioners of Inland Revenue ...	9 T.C. 101
Ogston *v.* Reynolds Sons & Co., Ltd. ...	15 T.C. 501
Wild *v.* Madame Tussaud's Ltd. ...	17 T.C. 127
George Humphries & Co. *v.* Cook ...	19 T.C. 121
Malayalam Plantations, Ltd. *v.* Clark...	19 T.C. 314
Commissioner of Income-tax, Bombay *v.* Sanjana & Co., Ltd. ...	2 I.T.C. 110

The Maharajadhiraj of Darbhanga *v.*
Commissioner of Income tax, Bihar
and Orissa ... ... 6 I.T.C. 209."

Release deed : The deed of release referred to in para 2 (c) of the Commissioner's Statement of the case and annexed thereto as Annexure A was as follows :—

"This Instrument made the 28th day of February 1936, Between Jeshanglal Mansookhlal Zaveri of Dhan Mansion, Bhatwadis, Bombay (hereinafter called the Releasor which expression shall mean and include the said Jeshanglal Mansookhlal Zaveri his heirs legal representatives and assigns where the context so admits) of the one part and Saralal Mansookhlal Zaveri of No. 128, Mogul Street, Rangoon (hereinafter called the Releasee which expression shall mean and include the said Saralal Manscokhlal Zaveri his heirs legal representatives and assigns where the context so admits) of the other part. Whereas the Releasor and the Releasee were carrying on business in co-partnership as Jewellers and Diamond Merchants under the name and style of "Mansookhlal Dolachand and Company" at Rangoon and Bombay and whereas the said partnership was dissolved by mutual consent as and from the day 28th October 1935, and Whereas the parties hereto have agreed to make such declarations as are hereinafter contained and give each other such release as are hereinafter contained, Now this Instrument Witnesseth as follows :—

1. The said parties hereto hereby declare that the said partnership between them was dissolved as and from the 28th October, 1935.

2. The Releasor hereby releases the stock-in-trade and the furniture of the said dissolved partnership and the right of the use and occupation of the shop at No. 128, Mogul Street, Rangoon, from all his right and claims.

3. The Releasor hereby gives up all his claims to the outstandings due to the said firm and hereby appoints the Releasee his attorney to collect, recover and receive all sums of money, interest, goods, articles and things due and payable or deliverable to the said dissolved partnership and on payment or receipt thereof to sign and give valid receipts or discharges for the same and if necessary to file suits actions and proceedings for the purposes of recovery thereof and to do all other things which the Releasee may think necessary for the purposes of the recovery of the same.

4. The Releasor hereby assigns all his right to the Trade Marks of the said dissolved partnership unto the Releasee and

hereby declares that he will not use hereinafter the said Trade Marks and that the Releasee shall have the sole right to the said Trade Marks.

5. It is hereby declared that the accounts of the said dissolved partnership have been settled and the Releasor has no claim against the Releasee in respect of the assets of the dissolved partnership.

6. The Releasee hereby declares that he has no claim of any sort or nature against the Releasor in respect of the said dissolved partnership and the account thereof.

7. The Releasor hereby declares that besides the debts shown in the books of account of the said dissolved partnership there are no other debts due by the said partnership.

8. The Releasor and the Releasee hereby declare that each of them shall have no claim of any sort or nature whatsoever against the other.

In Witness whereof the Releasor and the Releasee have hereunto set their respective hands the day and year first above written.

"........(Witness) ....(Signature)"

The Appellate Order referred to in the Commissioner's Statement of case which states the fact in detail runs as follows:—

" The firm of Mansookhlal Dolachand & Co., a firm of Jewellers in which the appellant, Saralal Mansookhlal Zaveri, was a partner, was dissolved on the 28th October 1935 and the appellant was treated as having succeeded to the business and assessed for 1936-37 on the profits of the previous year in accordance with the provisions of Sec. 26 (2). The appellant appeals against the assessment and contends that he did not succeed to the business of Mansookhlal Dolachand & Co. but started a new business of his own and that he is not liable to be assessed for 1936-37; but that on the other hand, the business of Mansookhlal Dolachand & Co., was discontinued on the dissolution of the partnership and as it was charged under the Income tax Act of 1918 the partnership firm should be assessed for 1936-37 in accordance with the provisions of Sec. 25 (3). The only point for determination, therefore is whether the appellant succeeded to the business of Mansookhlal Dolachand & Co., within the meaning of Sec. 26 (2).

2. Mansookhlal Dolachand & Co. was a firm composed of two partners, the appellant being one and his step-brother Jeshanglal Mansookhlal Zaveri being the other. When the partnership was dissolved the appellant carried on on his own account from the

date of dissolution business of the same kind on the same permises. The account books of the partnership firm were also taken over by him. A deed of release was executed in respect of the dissolution of the partnership and this deed recites that the partnership was dissolved by mutual consent from the 28th October, 1935, that Jeshanglal relinquished all claim to the stock-in trade and the furniture of the dissolved partnership and the right of the use and occupation of the shop premises, as also to the outstandings due to the firm, and that he assigned all his right to the trade marks of the firm to Saralal, who shall thereafter have the sole right to them. The deed further recites that the accounts of the dissolved partnership had been settled and that Jeshanglal had no claim against Saralal in respect of the assets of the partnership business. The terms of this deed of release, taken in conjunction with the fact that Saralal continued, without any interruption, to carry on business on the same premises and from the date of dissolution of the partnership prove conclusively to my mind that the business of the partnership firm was never in fact discontinued and that the business which Saralal is now carrying on is merely a continuation of that business. It is contended in appeal, however, that the creditors of the partnership firm were given goods in satisfaction of their debts and that this shows that the business of the firm was wound up at the time of dissolution of the partnership. This allegation was made before the Income-tax Officer also and the Income-tax Officer states in the assessment order that the accounts do not corroborate the allegation. He is not quite correct in saying this. The accounts, which have been re-examined in my presence, do show that certain creditors in Bombay (but not all) were given goods in satisfaction of their debts. The principal creditors were Manilal Rikhavchand Kothary and Mafatlal Bhogilal. The former's account was settled on the 22nd August 1935 and the latter's on the 27th August 1935. The ordinary business of the firm was, however, continued after these dates. There were continuous transactions till the 3rd September 1935 and sporadic transactions thereafter until the 23rd October 1935. However, I do not think that the settlement with some of the creditors, on which great stress is laid by the appellant, really helps his case at all. Whether the business was being finally wound up or was merely being re-constituted as a result of the withdrawal of one of the partners such a settlement was only to be expected and it does not of itself prove the case one way or the other. In any event there were other creditors (and debtors too) with whom a settlement was not

effected. The apellant took over the liabilities of the partnership amounting to nearly Rs. 12,000 as well as assets of Rs. 2,603-13-9. He also took over stock worth Rs. 8,682-8-0 and continued his business with it. The argument in appeal that he did not continue to use the old name of the business does not impress me. The principal name by which the business was known was undoubtedly Mansookhlal (the father's name) and his name is part of the present name of the business. This, coupled with the use of the old trade marks and the continuance of the business in the old premises, ensures to the appellant all the requisite goodwill of the business. There is no doubt at all that all the essential characteristics of succession are present in this case and I am fortified in this view by the observations of Courtney Terrel, C. J., in the *ante*-penultimate paragraph and in the paragraph which immediately precedes it of his judgment in the case of the *Maharajadhiraj of Darbhanga* v. *The Commissioner of Income Tax, Bihar and Orissa* (VI I.T.C. 209) in which his Lordship quotes the test for deciding such cases laid down by Cozens Hardy, L.J., in *Bell* v. *The National Provincial Bank of England* (V Tax Cas. 1). I therefore hold that the appellant succeeded to the business of Mansookhlal Dolachand and Co. within the meaning of Sec. 26 (2) of the Income-tax Act and was rightly assessed for 1936-37 under that section.

3. I confirm the assessment and dismiss the appeal."

U Tun Byu for the Commissioner of Income tax.

Kalyanwalla for the Assessee.

JUDGMENT.

ROBERTS, C. J.—The following question has been referred to this Court for determination in Civil Reference No. 17 of 1936 :—

"Whether there were materials on which the Income tax Officer and the Assistant Commissioner could conclude that the assessee had succeeded to the business carried on by Mansookhlal Dolachand and Company at 128, Mogul Street, Rangoon."

By Sec. 66 (2) and (3) of the Income tax Act, XI of 1922, an assessee may, provided certain conditions laid lown therein are satisfied, require the Commissioner to refer to the High Court any question of law arising out of an order either by the Assistant Commissioner or by the Commissioner himself or arising out of the decision of a Board of Referees, and the Commissioner shall within a specified time draw up a statement of the case and refer it with his own opinion thereon to the High Court. It is therefore always open

to an assessee who desires to argue the legal consequences of the facts to require a reference as to whether the Commissioner has attributed in law the correct legal consequence of the facts he has found. In the case under review the question was not happily framed, because it obscured the real question of law, namely, what were the legal consequences of the facts. Whenever the facts found by the Commissioner give rise to a consequential question, whether there is or is not a "succession" within the meaning of Sec. 26 (2) of the Income tax Act, XI of 1922, a question of law is involved. Section 26 (2) runs as follows:

"Whether at the time of making an assessment under Sec. 23 it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person the assessment shall be made on such person succeeding as if he had been carrying on the business, profession or vocation throughout the previous year and as if he had received the whole of the profits for that year".

The words "in such capacity" are important and should not be overlooked. In such a case as the present the proper question, and one which does not obscure the legal consequences of the facts, is this: "On the facts as stated, has the assessee succeeded in such capacity the person formerly carrying on the business within the meaning of Sec. 26 (2) of the Income tax Act?" In many instances the legal construction of the phrase "succeeded in such capacity" is not in issue because of the facts proved and in such cases there is no question of law which the Commissioner of Income tax can be required to refer under Sec. 66 (2). In my opinion this case is such a case. The major creditors had been paid off but the same business was being carried on, and in substance there was little or nothing more than the retirement of one of the partners from the business. But it was contended on behalf of the Commissioner of Income tax that the question of succession must always be a pure question of fact and a number of cases were cited which were supposed to support this proposition. It is really enough to say that they were all cases in which no question of legal construction happened to be involved. Once any legal difficulty as to the application of the phrase "succeeded in the same capacity" has been solved, then, in the words of the Lord President of the Court of Session in *Thompson and Balfour* v. *Le Page*, "the question whether there is in any particular case a succession or not is a question of fact". LORD SKERRINGTON in his judgment said:

"Primarily I should say that it is a question of fact

whether one trade has succeeded to the business of another but the question as put to us involves a question of law, namely, whether the Commissioners as reasonable men were entitled to draw the inference that the appellants had succeeded to the business".

Then in *Bell* v. *National Provincial Bank of England*, COLLINS, M.R., said:

"The finding of the Commissioners upon that part of the case is this: the Commissioners were of opinion that there was no succession within the meaning of the said fourth rule. That is, as my brother Mathew has pointed out, not a finding of fact that there was no succession, but that the particular kind of succession which took place in this case was not a succession within the meaning of the fourth rule."

He goes on to say that counsel relied on the authority of a Scotch case as showing that it is and must be a question of fact whether there has in point of fact been a succession or not:

"It may be in many cases, or in some cases, a question of fact. But it seems to me for the reasons I have already given that if it was a question of fact for the Commissioners in this case they have deliberately not decided it. They have presented to us a problem of law, and given us the benefit of their opinion on it, and if we do not agree with it we are entitled to say so. In my view if this is a finding (as I think it must be) of law that there is no succession within the meaning of the rule I find myself unable to agree with it".

I next pass on to consider *Commissioner of Income Tax, Burma* v. *N. N. Firm* decided by a Full Bench and reported in 11 Ran. 291. PAGE, C.J., there, after referring to the facts, said:

"Upon these facts the income tax authorities have held that there was a succession to the money-lending business of the undivided joint family within Sec. 26 (2) of the Income Tax Act. In my opinion it is manifest there was not a 'succession' within Sec. 26 (2) of the Act. In order that a person should be held to have succeeded another person in carrying on a business, profession or vocation it is necessary that the person succeeding should have succeeded his predecessor in carrying on the business as a whole. Where a business is split up and thereafter another person carries on part of the business, I am of opinion that he does not 'succeed' his predecessor in carrying on the business within Sec. 26 (2) of the Act.

This is only another way of saying that where a person has

carried on a business no one can be said to succeed him in such capacity when only part of the business is taken over. The learned Chief Justice went on:

"Further where there is no continuity in carrying on the business, and when one business has come to an end and after a time another business is started, it may be with the same assets and under the same conditions and in the same premises as the old business, the persons carrying on the new business do not 'succeed' those who had carried on the old business within Sec. 26 (2) of the Act."

We think that there can be no doubt that in application to the particular facts before the Court the element of non-continuity was a factor to be taken into consideration when the facts came to be ascertained and we have no doubt that the decision in *Commissioner of Income Tax* v. *N. N. Firm* was correct. But this latter sentence should not be interpreted as a proposition of law of necessarily universal application. The Court apparently had not had cited before it the judgment of FINLAY, J., in *Wild, H. M. Inspector of Taxes* v. *Madame Tussaud's Ltd.* In that case the old and well known Madame Tussaud's exhibition having been burnt down in March 1925, the company sold the site in July 1926, and a new company entered into possession, re-built the premises and opened them to the public in April 1928. It was held that the Commissioners could rightly arrive at the conclusion that there was in fact a succession by the new Company to the business of the old one.

The case was, as the learned Judge who tried it pointed out rather peculiar and special and depended perhaps even more than usual upon its own particular facts. The question really comes down in all such cases to this, whether there is a delay which as a matter of the law the Commissioner is bound to regard as forcing him to infer that, there was not a succession. The delay is a question of degree, and in some cases a delay may only mean a cesser of profit-making operations and never any real cessation of the business at all. The real test is the identity of the two businesses, and when this comes to be considered the reasons for any delay between closing down and opening up again may throw a light upon the correct solution. The conclusion at which I have arrived upon this reference is that though the Commissioner of Income tax may be required to refer any question of law, there is nothing in the law applicable to this case which stood in the way of the Commissioner coming to a decision in point of fact. The

question as propounded must therefore be answered in the affirmative. The Commissioner of Income tax is entitled to his costs of this reference, advocate's fee 20 gold mohurs.

SEN, J.—I agree.

DUNKLEY, J.—I agree.

MACKNEY, J.—I agree.

BRAUND, J.—I agree.

MOSELY, J.—I agree. As regards the form of the reference the Commissioner's proper course was pointed out in *Commissioner of Income-tax, Burma* v. *N. N. Firm*. The facts set out by the Commissioner must raise the specific question of law which in the view of the assessee arises: *Commissioner of Income Tax* v. *C. P. L. E. Chettiar Concern, Paungde*. The form of the reference made here is only suitable to cases where the sole question is whether there is a legal quantum of evidence to justify the finding of facts of the Income tax Officer, as in *Commissioner of Income-tax* v. *E. M. Chettiar Firm*. As regards what was said in *Commissioner of Income Tax* v. *N. N. Firm* at p. 504, that a person who carries on a part of a business only does not 'succeed' his predecessor in carrying on the business within Sec. 26 (2), this is perhaps stated too broadly. It has, I think, rightly been held in *Stockham* v. *Wallasey Urban District Council* that succession to a separate branch of a business constitutes succession within the meaning of the rule, and the Indian rule is for the purpose identical with the English.

LEACH, J.—I agree that the answer to the question propounded should be in the affirmative, but I wish to state that in answering the question in this way I do not accept the argument advanced on behalf of the Commissioner of Income Tax, that the question whether a person is to be deemed to be a 'successor' within the meaning of Sec. 26 (2) of the Income tax Act, is only one of fact. In order to answer the question it is of course necessary to ascertain the facts; but having ascertained them, it is then necessary to consider whether they constitute succession within the meaning of the section. Primarily, the question is one of fact, and the facts may be such that the case presents no difficulty; but the proper legal effect of a proved fact is essentially a question of law, as their Lordships of the Privy Council pointed out in *Nafar Chandra Pal* v. *Shukar Sheikh* and *Dhanna Mal* v. *Moti Sagar*. In the words of LORD BUCKMASTER in the former case, questions of law and of fact are sometimes difficult to disentangle; and the Court has the right to say whether the Income tax Officer has misdirected himself on

the facts. In *New Zealand Shipping Co. Ltd.* v. *Stephens* FARWELL, L. J., deprecated stating people out of Court, by stating under the guise of fact that which is really law. I do not say that there has been an attempt to do so in this case, but in view of the argument advanced by the learned Assistant Government Advocate it is necessary to emphasise that a question under Sec. 26 (2) is not ordinarily one of fact only.

Reference answered in the negative.

[IN THE JUDICIAL COMMISSIONER'S COURT OF SIND.]

SECRETARY OF STATE FOR INDIA v. OFFICIAL ASSIGNEE.

RUPCHAND BILARAM, A. J. C.

January 15, 1937.

PRIORITY OF DEBTS—INSOLVENCY OF ASSESSEE BEFORE SERVICE OF NOTICE TO FILE RETURN—INCOME TAX DEBT, WHETHER ENTITLED TO PRIORITY—'DEBT DUE TO THE CROWN', MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922)—PRESIDENCY TOWNS INSOLVENCY ACT (III of 1909), SEC. 49 (1) (a).

A person who had been carrying on business during the year 1934-35 was adjudicated insolvent on June 21, 1935. He was assessed to income tax in 1935-36 on his income for the previous year 1934-35, and under Sec. 49 (1) (a) of the Presidency Towns Insolvency Act the Income Tax Officer claimed priority for the income tax debt as a Crown debt as against other debts due by the insolvent. It was opposed on the ground that as the income tax had not become due on the date of the adjudication order, it was not a debt due to the Crown on that date and had no priority:

Held, *that the expression 'debts due to the Crown' in Sec. 49 (1) (a) includes not only debts which have become due to the Crown but also debts which are provable within the meaning of Sec. 46 (3) of the said Act; in other words, "all debts and liabilities, present or future, certain or contingent, to which the debtor is subject when he is adjudged an insolvent or to which he may become subject before discharge by reason of an obligation incurred before the date of such adjudication", and the income tax debt in question should therefore be given priority and should be paid in full out of the estate of the insolvent before a dividend was declared.*

Cases referred to:

. EX PARTE KEMP, IN RE FASTNEDGE [1874] (L.R. 9 Ch. A.C. 383).

OFFICIAL ASSIGNEE, MADRAS *v.* TRUSTEES OF THE PORT TRUST, MADRAS [1936] (A.I.R. 1936 Mad. 789).

Miscellaneous Appeal No. 5 of 1936 under Sec. 86 of the Presidency Towns Insolvency Act.

Charles M. Lobo, Government Pleader, for the appellant.

Suganlal Hassanand, for the Respondent.

ORDER.

RUPCHAND, A. J. C.—The facts of this case are hardly in dispute. The insolvent, Lilaram Jeoomal, worked as a weighman of the Steam Roller Flour Mills and made a profit in the year ending with March 31, 1935. Thereafter he did very little business, and, on June 21, 1935, he was adjudicated as an insolvent. On the strength of the provisions of Sec. 25 of the Income Tax Act he has been taxed to income tax for the year 1935-36 on the basis of his income during the previous years.

The pertinent parts of that section are as follows:

(1) Where any business, profession or vocation on which income tax was not, at any time, charged under the provisions of the Income Tax Act, 1918, is discontinued in any year, an assessment may be made in that year on the basis of the income, profits or gains of the period between the end of the previous year and the date of such discontinuance in addition to the assessment, if any, made on the basis of the income, profits or gains of the previous year.

(2) . . .

(3) Where any business, profession or vocation on which tax was at any time charged under the provisions of the Income Tax Act, 1918, is discontinued no tax shall be payable in respect of the income, profits and gains of the period between the end of the previous year and the date of such discontinuance, and the assessee may further claim that the income, profits and gains of the previous year shall be deemed to have been the income, profits and gains of the said period. Where any such claim is made, an assessment shall be made on the basis of the income, profits and gains of the said period, and if an amount of tax has already been paid in respect of the income, profits and gains of the previous year exceeding the amount payable on the basis of such assessment, a refund shall be given of the difference.

(4) Where an assessment is to be made under sub-Sec. (1) or sub-Sec. (3), the Income Tax Officer may serve on the person whose income, profits and gains are to be assessed, . . . a notice containing all or any of the requirements which may be included in a notice under sub-Sec. (2) of Section 22, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section.

It is common ground that the insolvent was not charged, at any time, with income-tax under the provisions of the Income Tax Act 1918. The insolvent was, therefore, liable to be taxed on the income which he had derived from his business during the year ending with March 31, 1935, and also in addition thereto on the income, if any, which he derived from April 1, 1935, up to June 21, 1935.

But the insolvent and the Official Assignee in whom has vested the estate of the insolvent, were served with notices as required by the Income Tax Act and the insolvent was taxed at Rs. 86-12-0 on the income which he had derived during the period ending March 31, 1935. A claim was then preferred before the Official Assignee under Section 49 of the Presidency Towns Insolvency Act, III of 1909, and he was required to give priority to this debt which was due to the Crown under Cl. (1) Sub-clause (a) of that section. The Official Assignee refused to give preference to this debt as a Crown debt with the result that the present appeal has been filed on behalf of the Secretary of State for India.

Mr. Suganlal has argued that the debt in question was not a debt due to the Crown on the date of the adjudication order. But I am afraid there is no substance in that argument. The expression 'a debt due to the Crown or to any local authority' includes not only a debt which had become due to the Crown but also a debt which is provable within the meaning of Section 46 (3) of the Presidency Towns Insolvency Act which includes within its ambit "all debts and liabilities, present or future, certain or contingent, to which the debtor is subject when he is adjudged an insolvent, or to which he may become subject before discharge by reason of any obligation incurred before the date of such adjudication."

The debt in question was undoubtedly a contingent liability to which the insolvent was subject on the date when he was adjudicated as an insolvent. It is no doubt true that, under the Income Tax Act, there was no obligation upon the insolvent to pay income-tax until and unless the provisions of that Act were complied with, that is to say, until he was served with a notice

calling upon him to fill up his form and the amount of tax payable by him was ascertained in the manner provided by the Act. But this only shows that the liability of the insolvent to pay the tax was contingent on those conditions being fulfilled. Both these conditions have been fulfilled and the contingent liability has now been converted into a debt due to the Crown. Even if the contingent liability had not been converted into a debt certain in amount, it fell within the purview of "a debt due to the Crown" within the meaning of Section 49 read with Section 46 (3) of the Act.

In support of the view that the expression 'debts due to the Crown' means a provable demand which the Crown has against the insolvent, whether such demand has become provable or not and whether it is in point of law strictly a debt or not, it is sufficient to refer to the observations of MELLISH, L.J., in *Ex parte Kemp; In re Fastnedge* [(1874) L.R. 9 Ch. A.C. 383, 388] and to the recent decision of the Madras High Court in *Official Assignee, Madras v. The Trustees of Port Trust, Madras* [(1936) A.I.R. Mad. 789 at 791] where the observations of MELLISH, L.J., have been referred to with approval.

For these reasons I hold that this debt should be given priority and should be paid in full out of the estate of the insolvent before a dividend is declared.

As the point in issue is a point on which there was no distinct authority of this court or of any other High Court in India one way or the other, I order that each party should bear his own costs.

Order accordingly.

[IN THE JUDICIAL COMMISSIONER'S COURT OF SIND.]

TOLARAM RAMDAS & CO.

v.

COMMISSIONER OF INCOME TAX, BOMBAY.

RUPCHAND BILARAM, J.C., and D.C. MEHTA, J.

October 18, 1937.

SUCCESSION TO BUSINESS—SOLE AGENCY FOR SELLING MACHINES MANUFACTURED BY ANOTHER—TRANSFER OF RIGHT OF SOLE AGENCY—TRANSFEREE, WHETHER ASSESSABLE AS 'SUCCESSOR IN BUSINESS'—NATURE OF SUCH TRANSFER—NATURE OF GOODWILL IN SOLE AGENCY BUSINESS—INDIAN INCOME TAX ACT (XI of 1922), SECTION 26 (2).

The assessees carried on business in their own name, and a part of that business was to sell sewing machines manufactured by Pfaff & Co., at Karachi and at Hyderabad, as their sole agents or distributors. Another firm, D & Co., likewise carried on as part of their business the business of selling sewing machines manufactured by the same manufacturers as their sole agents or distributors at Sukkur, Larkana and Jacobabad. By an agreement of 7th January 1931, D & Co., with the approval of Pfaff & Co., transferred to the assessees (i) *their stock-in-trade comprising of machines and spare parts,* (ii) *the right of D & Co., in certain hire purchase agreements, and* (iii) *the right acquired by D & Co., from Pfaff & Co., to represent them as sole agents or distributors for the sale of such machines. The assessees paid to D & Co., Rs. 1,750 on account of royalty overdue to Pfaff & Co., and paid Rs. 1,790 for the goodwill. After the said transfer the assessees continued to carry on business including the newly acquired business in their own name and D. & Co., likewise continued to carry on their old business except their business as agents of Pfaff & Co., which they had transferred to the assessees :*

Held, *on a reference of the Commissioner, that the right to represent Pfaff & Co., as their sole agents was a right which could be conferred by Pfaff & Co., and not by D. & Co.; the agreement of transfer really amounted to a relinquishment by D. & Co., of their right as the sole agents of Pfaff & Co., and the grant of a similar right by Pfaff & Co., to the assessees; the goodwill in the business was that of Pfaff & Co., and not of D. & Co.; and the assessees could not, therefore, be treated as successors in business of D. & Co., and assessed as such under Section 26* (2) *of the Indian Income Tax Act.*

Cases referred to:

ANNA TREGO AND WILLIAM SMITH *v.* GEORGE DRAFTFORT HUNT [1896] (1896 A.C. 7).

GINESI *v.* COOPER (14 Ch. D. 586).

THOMSON AND BALFOUR *v.* LE PAGE [1923] (8 Tax Cas. 541; Sess. Cas. 27 ; 61 Sc. L.R. 35).

WATSON BROS. *v.* LOTHIAN [1902] (4 Tax Cas. 441 ; 4 F. 795 ; 39 Sc. L.R. 604).

Case stated by the Commissioner of Income Tax, Bombay, under Sec. 66 (2) of the Indian Income Tax Act in the matter of the assessment of Tolaram Ramdas & Co., for the assessment year 1931-32. (Ref. Application No. 159 of 1934).

CASE.

Case stated by the Commissioner of Income-tax, Bombay Presidency and Aden, under Section 66 (3) of the Indian Income-tax Act, 1922 (hereinafter referred to as "the Act") for the decision of the questions of law set out in paragraph 5 below by the Court of the Judicial Commissioner of Sind.

2. **Facts of the case**:—Messrs. Tolaram Ramdas and Co., (hereinafter referred to as the "assessees") are carrying on business of selling sewing machines in Sind and have their principal place of business at Sukkur, within the jurisdiction of the Income-tax Officer, Sukkur. On 26th December 1930, they entered into an agreement (copy annexed hereto marked Exhibit A) with Messrs. Dhanoomal Wadhumal & Co., sole agents for Upper Sind for selling sewing machines manufactured by Messrs. G. M. Pfaff A. G. of Germany, whereby the latter agreed to transfer their said sole agency, subject to the approval of the Manufacturers, Messrs. G. M. Pfaff A.G., to the assessees, on certain conditions, *inter alia*, as under :—

(1) That the assessees should take over the entire stock-in-trade comprising of machines and spare parts as existing in December 1930;

(2) That they should pay Messrs. Dhanoomal Wadhumal Rs. 1,750 on account of royalty overdue to the German manufacturers;

(3) That they should pay Rs. 1,750 for goodwill in full and final settlement; and

(4) That they should undertake to buy the "lease accounts," *i.e.*, accounts of machines given out on the hire-purchase system.

This agreement was signed by Mr. Harbhagwandas Dhanoomal on behalf of Messrs. Dhanoomal Wadhumal & Co. The transfer of the agency was to be from the above date, but as subsequently it was found that Mr. Harbhagwandas could not legally sign the agreement a fresh agreement with identical terms was drawn up and signed on 7th January 1931 by the assessees on the one hand and Shrimati Kalavanti Bai, widow and sole heir of the late Mr. Wadhuram on behalf of Messrs. Dhanoomal Wadhumal & Co., on the other. A copy of the said agreement is annexed hereto marked Exhibit B. The approval of the manufacturers to this transfer for the agency was received by telegram on 30-12-1930. In virtue of this agreement, Messrs. Dhanoomal Wadhumal & Co., stopped their business with effect from 8th January 1931 and the assessees took it over. Later on, some dis-

pute arose as to the collection of outstandings on account of machines given out on the hire-purchase system. It was settled in or about May 1931 as is evident from the assessees' letter dated 23-5-1931 to Shrimati Kalavanti Bai, in which they wrote saying that they had given up their right under the agreement of 7th January 1931 (Exhibit B) with respect to the collection or recovery of old outstandings on account of the aforesaid machines in consideration of the sum of Rs. 1,400 received from Messrs. Dhanoomal Wadhumal & Co. A copy of the said letter is annexed hereto marked Exhibit C.

3. Messrs. Dhanoomal Wadhumal & Co. had their principal place of business at Shikarpur and were all along assessed by the Income-tax Officer, Shikarpur. At the time of their assessment for the financial year 1930-31, they raised the contention that they were succeeded in their business by the assessees and that the latter should, therefore, be assessed under the provisions of Sec. 26 (2) of the Act. This contention was not allowed by the Income-tax Officer and the Assistant Commissioner, but was allowed by the Commissioner in revision under his order dated 6-5-1932. The assessees were, thereupon, so assessed and from the order of assessment of the Income-tax Officer, Shikarpur dated 29-11-1932 it would appear that Messrs. Tolaram Ramdas & Co., actually agreed to this assessment as successors to Messrs. Dhanoomal Wadhumal & Co. A copy of this order is annexed hereto marked Exhibit D. The assessment was disputed subsequently and was cancelled by the Commissioner in September 1933 only on the ground that the Income-tax Officer, Shikarpur, had no jurisdiction as the assessees were already borne on the list of tax payers of the Income-tax Officer, Sukkur, and were actually assessed by that Officer for that year, *viz.*, 1930-31 on their income from other sources.

4. The Income-tax Officer, Sukkur, thereupon started proceedings to assess the assessees as successors in business to Messrs. Dhanoomal Wadhumal & Co. It was too late to take action for the year 1930-31. For the year 1931-32, they were already assessed on their income from business other than that as successors to Messrs. Dhanoomal Wadhumal & Co., and in order to assess the income from the latter source for which they were liable under Sec. 26 (2) of the Act and which had escaped assessment, the Income-tax Officer issued to the assessees a notice under Sec. 22 (2) of the Act read with Sec. 34 thereof, dated 20th February 1933. The assessees made a return of their income dated 13-3-1933

wherein they once again showed an income of Rs. 1,750. The Income-tax Officer, thereupon, after hearing them, by his order dated 18-12-1933, assessed them on a total income of Rs. 12,875 which was made up of Rs. 11,125 on account of income from the business of Messrs. Dhanoomal Wadhumal as sole agents for Upper Sind for Pfaff. Sewing Machine to which the assessees had succeeded and Rs. 1,750 as previously assessed on account of their other business at Karachi, Hyderabad, Shikarpur and Mirpurkhas. The assessees appealed against this assessment to the Assistant Commissioner of Income-tax, Sind who, by his order dated 6-4-1934, confirmed it. A copy of the said order is annexed hereto marked Exhibit E. The assessees then approached the Commissioner by their application dated 30th April 1934, requesting that the supplementary assessment be set aside. They also put in another application dated 28th May 1934 requesting that the questions of law proposed by them be referred under Sec. 66 (2) of the Act to the Honourable Court. Copies of these two applications are annexed hereto collectively marked Exhibit F. No relief was granted under Sec. 33 of the Act and a reference to the High Court was refused by the Officiating Commissioner on the ground that no question of law arose. The assessees having thereupon approached the Honourable Court, the statement of the case is submitted as per the order of the Court dated 17th June 1935.

5. Questions for the Decision of the Honourable Court—

The following questions are submitted for decision :

"(1) Whether in the circumstances of the case, the assessees have been rightly treated as successors to Messrs. Dhanoomal Wadhumal & Co. within the meaning of Sec. 26 (2) of the Indian Income-tax Act, 1922.

(2) If the answer to question (1) be in the affirmative, whether, in the circumstances of the case, the Income-tax Officer was correct in taking action under Sec. 34 of the Act to assess the assessees for the financial year 1931-32 on the income for the preceding year 1930-31 of the business of Messrs. Dhanoomal Wadhumal & Co. to which they had succeeded."

6. Opinion of the Commissioner :—As Sec. 66 (2) of the Act requires that the Commissioner should give his opinion while submitting a Statement of the Case, he begs to add that in his opinion both the questions should be answered in the affirmative. As regards the first question, the terms of the agreement Exhibits A and B leave no doubt that there has been a succession within the meaning of Sec. 26 (2) of the Act. As laid down by their Lord-

ships of the High Court of Judicature at Patna in Miscellaneous General Case No. 41 of 1931 in the matter of *Maharajadhiraj of Darbhanga* v. *The Commissioner of Income-tax, Bihar and Orissa*, "where there is a change of ownership in a business, but there has not been a change in the character of the business, nor any change in the character of the management nor any evidence that the business has been wound up and re-started or anything of the sort and the business is continued, there is a succession to the business within the meaning of Sec. 26 (2)." In the present case, these tests are satisfied. There is only a change in the ownership of the business but not in its character as the business continues to be that of selling Pfaff sewing machines manufactured by Messrs. G.M. Pfaff A.G. of Germany and the selling is done on the identical terms and conditions laid down by Messrs. Pfaff in the case of Messrs. Dhanoomal Wadhumal & Co. The agreement Exhibit B expressly states that the assessees took over the goodwill of the business on payment of a sum of Rs. 1,750 to the old proprietors Messrs. Dhanoomal Wadhumal & Co. They even paid the arrears of royalty due to Messrs. Pfaff and took over the entire stock in trade comprising of sewing machines and spare parts. The only conclusion possible, therefore, is that there has been a succession within the meaning of Sec. 26 (2) of the Act. The assessees lay stress on the dispute about machines given out on the hire-purchase system referred to in para 2 above but this subsequent dispute which was settled as indicated in the letter dated 23-5-1931, Ex. C, does not at all go to show that the assessees were not successors to the business.

7. The answer to the second question depends, of course, wholly on the answer to the first. If the assessees are successors within the meaning of Sec. 26 (2) of the Act, under the provisions of that section, they are to be held liable for the income earned in the "previous year" 1930-31 (ended on 31-3-1931), as if they alone carried on the business throughout the whole of that year and received the whole of the profits for that year therefrom. As the assessees have been found to be successors within the meaning of Sec. 26 (2) they are liable for the income from this business for the year 1930-31 and as that income was not assessed when the assessment for the year 1931-32 was originally levied on them, it escaped assessment and so was liable under Sec. 34 of the Act."

On February 9, 1937, the Court directed the Commissioner to submit his opinion on the following 4 questions:—

Question No. 1.—Did not the transfer of the monoply conferred upon Dhanumal by Messrs. Pfaff & Co., Ltd. with their consent

either by itself or coupled with the transfer of Pfaff Machines and the spare parts in stock and the transfer of the right to enforce the hire purchase agreements amount to succession within the meaning of Section 26 (2)?

Question No. 2.—Whether the subsequent cancellation of the transfer of the right to enforce the hire purchase agreements affects the question of such succession?

Question No. 3.—In the event of the assessee being held to be the successor of Dhanumal can he claim a right to examine the account books of Dhanumal for the period in question and/or claim to be present at the examination of such account books by the Income Tax Officer before he can be made liable for assessment on the footing of such account?

Question No. 4.—Where in the circumstances of the case the Income Tax Officer was correct in taking action under Sec. 34 of the Act to assess the assessees for the financial year 1930-31 of the business of Messrs. Dhanumal Wadhumal & Co. to which they had succeeded?"

In pursuance of the above order of the Court the Commissioner submitted the following further opinion:

"The Honourable Court has, now, raised four questions. As regards question (i), for reasons already stated in the opinion given in paragraph 6 of the Statement of the Case, the Commissioner is respectfully of opinion that the answer should be in the affirmative.

As regards question (ii) as already stated in the last sentence of the above paragraph 6 of the Statement of the Case, this subsequent dispute about machines given out on the hire-purchase system prior to the succession, which was settled as indicated in the letter dated 25-5-1931, Exhibit C, does not, at all go to show that the assessees were not successors to the business. The letter, Exhibit C, clearly shows that the assessees after succeeding to the entire business, parted with the right to collect certain outstandings, for a sum of Rs. 1,400. It was because they had taken over not only the entire business but everything pertaining thereto, that they succeeded in getting something even with respect to transactions entered into by their predecessors and got as much as Rs. 1,400 for parting with the right "with respect to the collection or recovery of the above-said outstandings" as stated in the letter, Exhibit C. A person carrying on a business can never be said to have ceased to do so, merely because he sells to another person a right to recover certain outstandings.

As regards question (iii), the Commissioner is respectfully of opinion that, as clearly laid down by their Lordships of the Privy Council in the concluding remarks in their judgment in the case of *Trustees Corporation (India) Limited* v. *The Commissioner of Income Tax, Bombay*, only questions of law arising out of the Assistant Commissioner's appellate order, Exhibit E, can be referred and considered by the Honourable Court. A perusal of the appellate order, Exhibit E, will show that the assessees did not raise any such question before that officer, claiming to have a right to examine the account books of Messrs Dhanoomal Wadhoomal and/or be present at the examination thereof. The Assistant Commissioner has, in consequence, given no decision in his appellate order as regards any such question and had it been raised, he would have surely done so as he has done as regards all the other points taken before him. Turning to the petition of appeal (copy annexed hereto, marked Exhibit G) therein the assessees have stated as under :—

"Nor did the learned Income Tax Officer summon the books of Messrs Dhanoomal Wadhumal & Co. for the accounting period of the assessment year 1931-32 which were admittedly in their possession and not in the possession of your petitioners."

This has been stated as part of the facts of the case and not under the Grounds of Appeal which have been given separately. In ground A under the said Grounds of Appeal the assessees refer to the "grounds contained in their Counsel's letter dated September 30, 1933" and paragraph 7 of these grounds which alone refers to the aforesaid account books is as under :—

"7. That the account books of Messrs Dhanoomal Wadhoomal & Co., have not been handed over to our clients and our clients are not aware if the Income Tax Officer, Shikarpur, has passed any order of assessment against Messrs Dhanoomal Wadhoomal & Co., for the year 1931-32 nor are they aware what the accounting period of Messrs Dhanoomal Wadhoomal & Co., was for the year 1931-32 nor their income up to the date on which our clients are deemed to have succeeded them which income is alleged to have escaped assessment."

"Unless, therefore, our clients get all those particulars they cannot be asked to pay any tax on the income earned by Messrs Dhanoomal Wadhumal & Co."

In this paragraph, a right to examine the said account books has not at all been asserted nor has any claim at all been put forward to be present at the examination of the said books. The

assessee having thus not claimed a right to examine the said accounts are to be present at their examination, either before the Income Tax Officer or the Assistant Commissioner and there being no reference whatever to any such claim in the appellate order under Sec. 31 of the Act, no such question can arise for consideration under Sec. 66 (2) of the Act. A mention of any such claim in the combined petition to the Commissioner under Secs. 33 and 66 (2) of the Act (Exhibit F) is not of any use in this connection as under Sec. 66 (2), the Honourable Court is authorised to consider only such questions of law as arise out of an appellate order under Sec. 31 of the Act. Not only was no such claim put forward but even a request to the Income Tax Officer to summon, under Sec. 37 of the Act, Messrs Dhanoomal Wadhumal & Co., was not made. Hence, to say in the petition of appeal that the Income Tax Officer did not "summon the books of Messrs Dhanoomal Wadhumal & Co." is meaningless. For the above reasons, the Commissioner submits that the answer to the question should be that as it does not arise out of the appellate order, Exhibit E, the Honourable Court can take no cognizance thereof.

In view of what is stated above, it is not necessary to say anything further about this question. The Commissioner however, begs leave to invite attention to the following extract from the judgment of the LORD PRESIDENT in *Thomson and Balfour* v. *Le Page* (*H. M. Inspector of Taxes*) (8 Tax Cases 541) :—

"The appellants complain that they do not have, in the form of possession of, or right of access to, Messrs Mickel and Company's books and accounts any means of checking the large addition to the assessment of their taxable income for the years immediately subsequent to their entry to the Victoria Saw Mills, which results from the inclusion in it of the profits of Messrs Mickel and Company's business prior to its transfer to themselves. One would have expected, since the goodwill was included in the purchase, that the appellants would have taken care to satisfy themselves before closing the bargain, with regard to the profitable character of the business for some years prior to the transfer. Perhaps it would have been prudent in a case of this kind to make a stipulation with regard to access to the books for the purpose of checking the assessment for income tax. But, whether this is so or not, the purchasers did not do this, and that is their own affair. The fact that they did not do so cannot to my mind affect the right of the Inland Revenue to enforce against them the provisions of the Income Tax Act."

The arguments of the assessees being the same as those of the appellants in the above case of *Thomson and Balfour* v. *Le Page*, the above decision must apply, moreover, under Sec. 26 (2) of the Act, the assessment is to be levied on the person who has succeeded to a business as if he had himself carried on the business throughout the previous year and received the profits thereof. It was for the assessees to prove by evidence what those profits were. They failed to do so and did not even ask the Income Tax Officer to issue a summons under Sec. 37 of the Act and get the account books of Messrs Dhanoomal Wadhumal & Co. Having failed to do so and having left the burden of ascertaining that income wholly on the Income Tax Officer, they cannot now make any grievance out of that. If they could not see the said account books, the fault was wholly theirs as, as stated in the above quotations from the judgment in the case of Thomson and Balfour, they should have themselves arranged to take over from Messrs Dhanoomal Wadhumal their books in view of their liability to tax under Sec. 26 (2) of the Act. Not only did they fail to do so but even at the time of assessment, they did not move the Income Tax Officer to take action under Sec. 37 and procure the production of the books.

From the assessment order of the Income Tax Officer (copy annexed hereto marked Exhibit H), it will be seen that he has given therein details as to how the income taxed was arrived at. The assessees applied for and were given a copy of that order but even then before the appellate officer they raised no question as regards the quantum of the assessment and never asked the Assistant Commissioner to summon under Sec. 37 Messrs Dhanoomal Wadhumal with their books so that they might challenge the correctness of figures referred to in the Income Tax Officer's order. The only inference that can be drawn from their conduct is that they had nothing to say as regards the quantum of the assessment and that the grievance as regards the said account books is wholly an afterthought.

As regards question (iv) attention is invited to paragraph 7 of the opinion in the statement of the case to which the Commissioner has nothing to add."

Dipchand Chandumal and *Suganlal Hassanand*, for the Assessees.

Partabrai D. Punwani, Advocate General, for the Crown.

JUDGMENT.

RUPCHAND, J. C.—On February 9, 1937, this reference came up for consideration before us. On that day we re-settled the issues and passed an order permitting the Income Tax Commissioner to submit his opinion on the issues framed by us. He has submitted his opinion and we have considered the same. We have also heard the arguments of both parties, and are now in a position to deal with the issues.

Issue No. 1. This issue is not so simple as it might, at first sight, appear to be. Both sides have advanced lengthy arguments before us. In order to fully appreciate these arguments it is necessary to refer to some of the salient facts of the case on which there is no dispute.

It is common ground (1) that the assessees carried on business in their own name before the alleged transfer of the business in question was made to them and a part of that business was to sell sewing machines manufactured by Messrs Pfaff and Company at Karachi and at Hyderabad in their capacity as their sole agents or distributors; (2) that the firm of Messrs Dhanumal Wadhumal and Co., (hereinafter referred to as Messrs Dhanumal) likewise carried on business in their own name and a part of their business was likewise to sell sewing machines manufactured by Messrs Pfaff and Co., as their sole agents or distributors, but at Sukkur, Larkana and Jacobabad, and not at Hyderabad or Karachi; (3) that the alleged transfer by Messrs Dhanumal to the assessees was not of the whole business carried on by them; (4) that at first this alleged transfer referred to (a) the sale of the stock-in-trade consisting of machines manufactured by Messrs Pfaff & Co., and spare parts of such machines at cost, (b) the right of Messrs Dhanumal in certain hire and purchase agreements (referred to as leases) which they had secured in respect of Pfaff Machines, and (c) the right acquired by them from Messrs Pfaff and Co., to represent them as sole agents or distributors for the sale of such machines; (5) that by a subsequent agreement the transfer of the rights of Messrs Dhanumal in the hire and purchase agreements was by mutual consent cancelled; (6) that the right to represent Messrs Pfaff & Co., as their sole agents was not transferable without their permission and this permission was duly obtained and (7) that after the said transfer the assessees continued to carry on business in their own name and that Messrs Dhanumal likewise continued to carry on business in their own name as before, the only difference being that in

addition to representing Messrs Pfaff & Co., as their sole agents at Karachi & Hyderabad, the assessees represented them as such agents at Sukkur, Larkana and Jacobabad as well and that Messrs Dhanumal discontinued to represent Messrs Pfaff & Co., as sole agents in those places.

The right of the parties to represent Messrs Pfaff & Co., as their sole agents or distributors has been referred to in the course of arguments as a monopoly. The terms on which the so called monopoly was originally granted either to Messrs Dhanumal or the assessees or the terms on which the transfer of the monopoly by Messrs Dhanumal to the assessees was sanctioned are not on the record. But it appears that a certain sum of money which is referred to as royalty was payable by the selling agents to Messrs. Pfaff & Co. on each machine which was sold, and that this royalty was payable in addition to the invoiced cost of each machine.

It is also necessary to refer in greater detail to the two agreements between Messrs. Dhanumal and the assessees.

The first agreement recites that the assessees agree (a) to buy the entire stock-in-trade of Pfaff machines and spare parts of such machines at cost, and (b) to take over the lease (hire and purchase agreements) for a sum which was the cost of the machines on the dates when they were given on hire less such amount as was received by Messrs. Dhanumal as hire with interest thereon at 6 per cent per annum. The said agreement further recites (1) that the assessees agree to pay to Messrs. Pfaff & Co. Rs. 1,750 being the amount of overdue royalty and to pay to Messrs Dhanumal a further sum of Rs. 1,750 for "goodwill in full and final settlement"; (2) that the payment of the above sums will not affect the right of Messrs. Pfaff & Co. or the amount due to them by way of credit notes etc. and (3) that in consideration of the promises made by the assessees Messrs. Dhanumal agree subject to confirmation by Messrs. Pfaff & Co., to transfer to the assessees "the entire Pfaff's sole agency for Sukkur, Larkana and Jacobabad Districts." At the end of the agreement a proviso has been added to the effect that the assessees will pay the rent of the shops in which Messrs Dhanumal carried on their business.

The only material alteration in the second agreement is that Messrs Dhanumal retained their rights under the hire and purchase agreements and that in consequence thereof they gave credit to the assessees for Rs. 1,400 with the result that in addition to the costs of the stock-in-trade purchased by them and Rs. 1,750 to be

paid by the assessees as overdue royalty they paid Rs. 300 more to Messrs. Dhanumal for such rights as were transferred to them.

It is clear from the agreements referred to above that what was transferred to the assessees was the "entire Pfaff sole agency for Sukkur, Larkana, Jacobabad Districts," or in other words, the right to represent the manufacturers as their sole agents for sale of their machines in the areas referred to above.

Now, the right to represent Messrs. Pfaff & Co. as their sole agents was a right which could only be conferred by them and not by Messrs. Dhanumal. Reading the main agreement as a whole, and giving due regard to the relative positions of the parties and the fact that this agreement had to take effect only after its confirmation by Messrs. Pfaff & Co. it would appear that the agreement really amounted to a relinquishment by Messrs. Dhanumal of their right to represent Messrs. Pfaff & Co. as their sole agents in the areas referred to above and the grant of a similar right by Messrs. Pfaff & Co. to the assessees.

Section 26 of our Act is based upon Rule 11, Sch. D. of the English Income Tax Act, 1918. That rule was amended in 1928 placing the successor of a business on the same footing as that of a person who had set up or commenced a new business.

Our attention has been invited to rulings both under Rule 11 of the English Act prior to its amendment and under Sec. 26 of our Act. But none of those rulings refers to a case like the present where the subject matter of transfer is the right to represent the manufacturer of a particular article in a specified area and where such transfer is of no effect without the consent of the manufacturer. We therefore propose to deal with only two of the cases cited before us which have a certain bearing upon the point in issue. These cases are (1) *Watson Brothers* v. *Lothian* (1902) 4 Tax Cases, 441 on which considerable reliance has been placed on behalf of the assessees, and (2) *Thomson and Balfour* v. *Le Page* (1923) 8 Tax Cases, 541, which has been made so much of by the Advocate General.

In the first case the sale of a "tramp" ship without more was held not to render the transferees liable to pay income tax as successors in business of the transferors. In that case the Lord President has said at page 444—

"... in short there is a sale of a corporeal moveable which happened to be a ship. Well, it appears that this ship had not traded between any definite ports or upon any definite route and indeed it does not appear that she was engaged in any definite

trade but it is said that she took whatever freights were likely to be remunerative; in short, she seems to have been what I think in shipping language is called a sort of tramp steamer. It is said that no debts were taken over by the purchasers, nor were any books belonging to the old owners transferred to the possession of the present owners. The only thing transferred was the ship. It is not said that there were any introductions to the past customers, or that there was any transfer of any of the machinery which would enable the purchasers of such a corporeal moveable to endeavour to continue this trade. If the books had been transferred, if a list of customers had been transfered, if there had been any instructions or recommendations given, a very different state of facts would have occurred. . . . Well, then, the question comes to be whether the fourth paragraph of the case under the Act applies and the first part of that deals with the computation of duty in case of a change of partners; that is to say, where some change has taken place within a firm, or within a partnership and that is treated as a continuing thing, notwithstanding the change in one or more partners and provisions are made for the assessment of such a case. That, of course, is not the case we have to deal with, which comes second in the fourth head, and that is—if any person shall have succeeded to any trade, manufacture, adventure, or concern, or any profession, within such respective periods, the duty payable shall be estimated in a particular way; the way there again being determined by a regard to the previous history of that trade, manufacture, adventure, or concern, all upon the view that what was bought was a continuing thing, a continuing adventure, with all its prospects, with all its trade connections and with all those things which result in the making of a profit. In short, it is treated as a case analogous to a change in a partnership. Well, has anything of that kind happened here? It appears to me very clear that nothing of the kind has happened."

Now, this ruling establishes three broad propositions (1) that the transfer by way of sale of a corporeal moveable, in this case the stock-in-trade of Pfaff machines and the spare parts of such machines, by itself, does not make the transferee a successor of the business of the transferor; (2) that in determining whether or not the transferee is a successor or not, the court will have regard to the previous history of the particular trade, manufacture, adventure or concern in issue, and find out whether "what was bought was a continuing thing, a continuing adventure with all its prospects, with all its trade connections and with all those things which re-

sult in the making of a profit" and (3) that the case of a successor to a business is analogous to a change in partnership.

Neither the previous history of the trade in this case which was that of selling Pfaff machines as sole agents of Pfaff & Co. nor the subsequent events show that what was bought was a continuing adventure nor is this a case analogous to a change in partnership.

The transferees carried on business both before and after the transfer in their own name. They depend upon the will of the manufacturers to supply them with machines, to permit them to act as their agents and to sell the machines as such agents. They depend on all things which resulted in the making of a profit upon the goodwill of Messrs. Pfaff & Co. and not upon the goodwill of Messrs. Dhanumal.

The case of *Thomson and Balfour* v. *Le Page* (1923) 8 Tax cases 541] if carefully analysed, lays down no different proposition of law. It has been rightly pointed out in that case that the question whether there is in any particular case a "succession" or not is a question of fact. In that case, unlike the case of *Watson Brothers*, [(1902) 4 Tax Cases 441] the transferees were held to be successors but on facts which were quite different. In this case there was a transfer of a business properly so called and the facts relied upon in support of the decision appear with sufficient clearness in the following passage which is at page 549:

" In the present case one is met at the threshold of the enquiry with the fact that Messrs. Mickel's business was bought along with their mills, for the goodwill was expressly included in the subjects sold. Again, there is the fact that as soon as the sale was concluded circulars by both the purchaser and the seller were issued to the public announcing, on the part of the purchasers, that it was their intention to add to their own business Messrs. Mickel and Co's. joinery business, which they describe as a speciality of the Messrs. Mickel carried on by them for many years, and on the part of the sellers, that they hoped the good relations which had existed between their old customers and themselves would be extended to their 'successors', an unfortunate description of the appellants from their present point of view. The sellers added that, from their knowledge of the appellants, they could be relied upon to give their utmost attention to orders entrusted to them. These two facts are perhaps not conclusive, but they are very weighty, for it is imposible for the appellants to say that—if Messrs. Mickel's connection and reputation had any value—they

did not acquire the benefit of it. What they do say, and what is found in fact in the very clearly stated case before us, is this— that at the moment of their acquisition of Messrs Mickel & Co.'s business there were no current orders; that they have not been able to identify any orders they have got since Whit Sunday, 1919, as orders from Messrs Mickel & Co.'s customers. Those are the two important matters of fact found, for the circumstance that they did not look at the books of Messrs Mickel & Co. is nobody's fault but their own. They chose to buy the goodwill without making any enquiry into the records of the business and without getting even a list of customers. But the circumstance that no customer of Messrs Mickel & Co. has been successfully traced and identified amongst those giving orders after Whit Sunday 1916, does not carry the matter very far, and it is not inconsistant with the acquisition of a business or goodwill to say that owing to the very disturbed conditions of trade at the time of purchase there were in fact no current orders".

The above case no doubt establishes the point urged by the learned Advocate General that the fact whether the outstandings of a business are transferred or not is immaterial in determining whether there has been a 'succession' or not, and so far as the present case is concerned that is all that can be said in favour of the Crown. All the other facts are different. So far as the intending purchasers of Messrs Pfaff & Co. were concerned, the connection and reputation of Messrs Dhanumal had no value whatsoever; such intending purchasers looked to the reputation of Messrs Pfaff & Co. and were prepared to buy machines from any person whether it was Mr. A or Mr. B who was permitted by Messrs Pfaff & Co. to sell their machines.

The learned Advocate-General has invited our attention to the expression "goodwill" used by the Lord President in the above case, and has argued that, as in the present case the assessees have purchased the goodwill of the business of Messrs. Dhanumal, they are successors of that business. But the mere use of the expression 'goodwill' in the agreement is not sufficient to warrant our holding that Messrs Dhanumal had any goodwill in the right which they purported to transfer to the assessees. It is perhaps as difficult to define 'goodwill' as it is to define "successor in business".

In *Anna Tregó and William Smith* v. *George Draftford Hunt* (1896) A.C. 717, LORD HERSCHELL has said:

"The question, what is meant by 'goodwill' is, no doubt, a

critical one. Sir George Jessel, discussing in *Ginesi* v. *Cooper*, 14 Ch. D. 586, the language of Wood, V.C., which I have just quoted said "Attracting customers to the business is a matter connected with the carrying of it on. It is the formation of that connection which has made the value of the thing that the late firm sold, and they really had nothing else to sell in the shape of goodwill".

"The present Master of the Rolls took much the same view as to what constitutes the goodwill of a business. I cannot myself doubt that they were right. It is the connection thus formed, together with the circumstances whether of habit or otherwise, which tend to make it permanent, that constituted the goodwill of a business. It is this which constitutes the difference between a business just started, which has no goodwill attached to it, and one which has acquired a goodwill. The former trader has to seek out his customers from among the community as best he can. The latter has a custom ready made".

Applying this definition to the present case, the goodwill is as already observed that of Messrs Pfaff & Co., and not of the person whom they appoint as their sole agent for any particular area.

As said above, we have not got the terms on which Messrs. Dhanumal were appointed as agents of Messrs Pfaff & Co. It is possible that they were appointed as such agents for a fixed period and that they were therefore entitled to a certain amount of compensation before their agency could be terminated and what is shown as the amount paid as goodwill perhaps represents such compensation. It is also possible that this amount which consists of only Rs. 1,750 overdue royalty and Rs. 300 more paid to Messrs Dhanumal represents the estimated difference between the sale price and cost price of machines and parts of machines which were in stock and were transferred to the assessees. Lastly, it is equally possible that Messrs Pfaff & Co., wished that the widow of Dhanumal should receive a certain gratuity before her agency was terminated.

It is hardly necessary for us to speculate on the causes which led to the payment of the above sums. Reading each of the agreements as a whole, we are afraid we are not prepared to hold that, on the facts of this case, the assessees are successors in business of Messrs Dhanumal.

We accordingly hold on issue No. 1 against the Crown.

Under the circumstances there is no occasion for us to go into the other two issues except to observe in respect of issue No. 2 that the Income Tax Commissioner has pointed out that as the

assessees never asked for a summons against Messrs Dhanumal for production of their books, this issue does not at all arise.

The assessees are entitled to their costs which should be taxed in the usual way.

Reference answered in the affirmative.

[IN THE MADRAS HIGH COURT.]

ANDHRA INSURANCE CO. LTD. v. COMMISSIONER OF INCOME-TAX, MADRAS.

LEACH, C.J., VARADACHARIAR, J., and KING, J.

October 22, 1937.

INSURANCE COMPANY—ASSESSMENT OF PROFITS—'LAST PRECEDING VALUATION'—NEW VALUATION PERIOD EXPIRING BEFORE RETURN—VALUATION NOT MADE BEFORE RETURN—ASSESSMENT ON OLD VALUATION—VALIDITY—NEW VALUATION DISCLOSING HIGHER ANNUAL PROFITS—LEVY OF SUPPLEMENTARY ASSESSMENT UNDER SEC. 34—LEGALITY—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 34—INCOME TAX RULES, R. 25.

The words 'last preceding valuation' in Rule 25 of the Indian Income Tax Rules mean the last preceding valuation at the time of the return and cannot be construed as meaning the valuation covering the last valuation period terminating before the first day of April of the year of assessment.

The first actuarial valuation of an insurance company was made in December 1930 in respect of the period of 4 years which ended on 31st December 1929, and in accordance with Rule 25 of the Indian Income Tax Rules the company was assessed for the years 1930-31, 1931-32, 1932-33 and 1933-34 on the average annual profits disclosed by this valuation, namely, Rs. 8,294. The second actuarial valuation for the 4 years ending on the 31st December 1933 was made in December 1934 and disclosed an average annual net profit of Rs. 39,755. The company had to file a return of its income in June 1934 under Sec. 22 of the Income Tax Act and, as the second valuation was made only in December 1934, the company made a return of income for the year 1934-35 on the basis of the first valuation and was assessed accordingly on an income of Rs. 8,294. As the second valuation disclosed larger profits the Income Tax Officer took proceedings under Sec. 34 and assessed the

company on a further sum of Rs. 31,461 (being the difference between Rs. 39,755 and Rs. 8,294) as income which had escaped assessment:

Held, *on a reference by the Commissioner, that the 'last preceding valuation' of the surplus of the company for the purposes of assessment for the assessment year 1934-35 was, in the circumstances of the case, the valuation covering the years 1926-29 and not that covering the years 1930-33; that no income had therefore escaped assessment and the assessment made under S. 34 was illegal.*

Held also, *that Rule 25 is of a mandatory character and provides the only manner in which the income, profits and gains of life insurance companies can be ascertained.*

LAKSHMI INSURANCE CO. LTD., *v.* COMMISSIONER OF INCOME TAX, LAHORE, (I.L.R. 12 Lah. 757) *followed.*

Case stated by the Commissioner of Income tax, Madras, under Sec. 66 (2) of the Indian Income tax Act (XI of 1922) in the matter of the assessment of the Andhra Insurance Company Ltd., for the assessment year 1934-35 [O. P. No. 34 of 1937].

CASE.

"I have the honour to refer the following case for decision of the Honourable Judges of the High Court under Sec. 66 (2) of the Income tax Act (XI of 1922).

2. The petitioner is a company incorporated in British India carrying on life assurance business at Masulipatam within the jurisdiction of the Income tax Officer, Masulipatam Circle. It is thus a Life Assurance Company for the purposes of the Indian Life Assurance Companies Act (VI of 1912) as is clear from Sec. 3 of the said Act. Under Sec. 8 of the said Act every Life Assurance Company shall once in every five years or at such shorter intervals as may be prescribed by the instrument constituting the Company or by its regulations or byelaws, cause an investigation to be made into its financial condition, including a valuation of its liabilities, by an actuary. Under Article 140 of the Articles of Association of the petitioner Company, this investigation and valuation has to be made once in every five years or at such shorter period as the directors shall determine. In accordance with this Article the directors appear to have prescribed a period of 4 years for a valuation.

3. The company was incorporated on 28th August 1925. The first actuarial valuation was made in December 1930 in respect of the period of 4 years ended 31-12-1929. Under Sec. 3 of the Income tax Act tax shall be charged in respect of all income,

profits and gains of the previous year. Under Rule 25 of the rules framed under Sec. 59 of the Income Tax Act, "in the case of Life Assurance Companies incorporated in British India whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the life assurance business shall be the average annual net profits disclosed by the last preceding valuation......". In accordance with these provisions the company was assessed for the years 1930-31, 1931-32, 1932-33 and 1933-34 on the annual average of the profits disclosed by that valuation made in December 1930. The whole of the profits of the 4 years ending 31-12-1929, as disclosed by that valuation, was thus subject to assessment in the 4 years mentioned above.

4. Under Sec. 22 (1) of the Act, the principal officer of very company has to furnish to the Income tax Officer a return of the total income of the Company during the previous year. This return has to be furnished on or before the 15th June in each year. For the tax year 1934-35 the petitioner Company furnished a return of its income to the Income tax Officer on 30-6-1934. The return showed Rs. 8,294 as the income of the year ended 31-12-1933. This was the annual average of the net profits of the company disclosed by the actuarial valuation made in December 1930. It was also the income adopted for assessment in each of the years 1930-31 to 1933-34. The Income tax Officer accepted the return and assessed the company on Rs. 8,294 on 30-6-1934.

5. When the Income tax Officer made the above assessment, a period of 4 years had elapsed since the first actuarial valuation, but the results of the second valuation which was due in respect of the period ended 31-12-1933 had not been ascertained. This valuation was completed in December 1934. It showed a surplus of Rs. 1,58,381. The average annual net profit computed in accordance with rule 25 was Rs. 39,755. The Income tax Officer considered that the company was liable to be assessed on this average for the tax year 1934-35. As the Company had already been assessed on a sum of Rs. 8,294 he held that the difference, *viz.*, Rs. 31,461 had escaped assessment and accordingly issued a notice under Sec. 34 on 19-11-1935 of his intention to assess the income that had escaped assessment. On its return dated 8-1-1936 the company repeated the income of Rs. 8,294 on which it had originally been assessed. The company contended that on the date of the original assessment the only basis available was the surplus disclosed by the 1st actuarial valuation and that the materials on which the second valuation was

made had not become available at the time. The company therefore argued that no income had escaped assessment and objected to the proposal to take proceedings under Sec. 34. The Income-tax Officer overruled the objection and made an assessment of the income which, in his opinion, had escaped assessment.

6. The petitioner's appeal to the Assistant Commissioner was unsuccessful.

7. The company now requires me to refer to the High Court the 3 questions set out in its application. I refer the following question as being in my opinion the question of law arising on the facts of this case :—

"Whether the 'last preceding valuation' of the surplus of the company for the purposes of the assessment to be made for the year of assessment 1934-35 was in the circumstances of the case that covering the years 1926-29 or that covering the years 1930-33."

It appears to me that the "last preceding valuation" on the basis of which the assessment for 1934-35 fell to be made, was necessarily that covering the period 1930-33 and that the Company is not entitled to claim assessment on a different basis merely because the valuation was not completed at the time when the assessment happened to be made. The suggestion appears to be that the expression "last preceding valuation" means the last valuation preceding the actual date of the assessment. This, although no doubt an attempt will be made to justify it as a strictly literal interpretation is not, in my opinion a reasonable construction of the rule. I may point out, that if this view were correct, it would be open to an Income-tax Officer, in a case similar to the present except for a fall, instead of a rise, in the volume of the profits, to secure an unfair advantage to the revenue by making his assessment in the early part of the year, without waiting for the second valuation. It cannot be the intention of the rule, that the assessment for a given year should be made on a different figure, according to whether it happens to be made before or after the date on which a valuation is completed. On a fair and reasonable construction, the words "last preceding valuation" must be taken to mean the valuation covering the last valuation period terminating before April 1st of the year of assessment."

N. Rama Rao, for the Assessee.

M. Patanjali Sastri, for the Commissioner.

JUDGMENT.

The assessee in this case is a life insurance company carrying on business at Masulipatam, having been incorporated in the year

1925. Under the provisions of Sec. 8 of the Indian Life Assurance Companies Act, 1912, a life assurance company is required once in every five years, or at such shorter intervals as may be prescribed by the instrument constituting the company or by its regulations or bye-laws, to cause an investigation to be made by an actuary into its financial condition, including a valuation of its liabilities. The company decided that the valuation should take place every four years. The first valuation was made in December 1930 and was for the period ended 31st December 1929. The next valuation took place in December 1934 and this was for the four years ended 31st December 1933. Under Section 22 of the Indian Income-tax Act, the principal officer of every company shall prepare and on or before the fifteenth day of June in each year, furnish to the Income-tax Officer a return, in the prescribed form and verified in the prescribed manner, of the total income of the company during the previous year. On the 30th June 1934 the Secretary of the company furnished the return contemplated by this section. It was fifteen days late, but the Income-tax Officer accepted it and assessed the company to income-tax on the basis of the return. Rule 25 of the Income-tax Rules provides that in the case of life assurance companies incorporated in British India, whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the life assurance business shall be the average annual net profits disclosed by the last preceding valuation. This rule was framed under the provisions of Section 59 of the Act and has effect as if enacted in the Act.

The return which the Secretary furnished to the Income-tax Officer on the 30th June 1934 was based on the valuation for the period ended 31st December 1929 and on this basis the income of the company for the account year 1933 was Rs. 8,294. The company paid the amount of the tax; but when the valuation for the four years ended 31st December 1933 was published in December 1934 it was found that the profits had greately increased. If the assessment has been based on this return the amount of the income would have been Rs. 39,755 instead of Rs. 8,294. When this was discovered by the Income-tax Officer he issued a notice under Section 34 of the Act, intimating his intention to assess the company in respect of the year 1933 on the further sum of Rs. 31,461, (the difference between Rs. 39,755 and Rs. 8,294) on the ground that this was income which had escaped assessment. The company objected and asked the Commissioner of Income-tax to refer the matter to this Court under the provisions of Section 66 (2).

The Commissioner has accordingly referred the following question :

"Whether the 'last preceding valuation' of the surplus of the company for the purposes of the assessment to be made for the year of assessment 1934-35 was in the circumstances of the case that covering the years 1926-29 or that covering the years 1930-33?"

The Income-tax Commissioner in his reference has expressed the opinion that the Income tax Officer is entitled to reopen the assessment under Section 34, notwithstanding the wording of Rule 25. He contends that the expression "the last preceding valuation" must be taken to mean the valuation covering the last valuation period terminating before the 1st of April of the year of assessment. This contention ignores the wording of Rule 25. The wording is perfectly clear and says that the income of a life assurance company shall be the average annual net profits disclosed by the last preceding valuation, that is the last preceding valuation at the time of the return. The return must be made by the 15th of June after the end of the year of account, unless the Income-tax Officer extends the time at the instance of the assessee. In this case the last preceding valuation when the return was submitted was the valuation made in December 1930 for the period ended 31st December 1929. As I have said, the words of the rule are perfectly clear and they must be given their plain meaning. Giving them their plain meaning, the return made in June 1934 was made on the proper basis.

In these circumstances the Income-tax authorities had no right to serve a notice under Sec. 34 of the Act, as no income had escaped assessment. The return had been made in accordance with the statute and the tax had been paid. In *The Lakshmi Insurance Co., Ltd., Lahore* v. *The Commissioner of Income-tax* (12 Lah. 757), it was pointed out that Rule 25 is of a mandatory character and provides the only manner in which the income profits and gains of life assurance companies can be ascertained and that it is not open to an Income-tax Officer to depart from its provisions. With this opinion we are in entire agreement. It follows that the answer to the reference is that the last preceding valuation of the surplus of the company for the purposes of the assessment for the year 1934-35 was that covering the years 1926-29. As the company has succeeded, it will be entitled to its costs which we fix at Rs. 250.

Reference answered accordingly.

[IN THE MADRAS HIGH COURT.]

TRICHINOPOLY TENNORE HINDU PERMANENT FUND LTD. *v.* COMMISSIONER OF INCOME TAX, MADRAS.

LEACH, C. J., VARADACHARIAR, J.; and KING, J.

October 22, 1937.

MUTUAL BENEFIT SOCIETY—BANKING BUSINESS—CREATION OF NOMINAL MEMBERSHIP FOR BORROWERS—PROFITS DISTRIBUTED TO REAL SHAREHOLDERS—COMPANY, WHETHER MUTUAL BENEFIT SOCIETY—INCOME, WHETHER TAXABLE—AMOUNTS PAID TO SHAREHOLDERS IN EXCESS OF CONTRIBUTION, WHETHER INTEREST ON BORROWED CAPITAL—INCOME TAX PROCEEDINGS—APPLICABILITY OF RULE OF *Res judicata*—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 10 (2) (iii).

In the original memorandum of the assessee, a limited company, its main objects were stated to be (i) to enable persons to save money and (ii) to enable persons to secure loans at favourable rates of interest on sufficient securities, and its nominal capital was made up of a certain number of fully paid up 'permanent shares' and some 'term shares.' The company made profits by advancing loans to outsiders and it was accordingly decided by the High Court that it was not a mutual society and its income was accordingly assessed. The company thereupon altered its constitution by substituting the word 'member' for 'person' in the above mentioned object clauses, creating a new class of shares called 'ordinary shares' of Re. 1 each, and issuing them to persons who under the former scheme would have been non-member borrowers. These shares were also withdrawable after 2 years. The company contended that it had by the above alterations become a mutual benefit society. This contention was upheld by the revenue authorities and its income was not taxed for the years 1927-28 to 1930-31. In 1931 the authorities took a different view and levied assessment under Sec. 34 of the Act for the year 1930-31. On a reference by the Commissioner :

Held, (i) *that in view of the fact that the membership of the borrowers was only nominal and the profits of the company were distributed to its real shareholders, the company was not, even after the alteration of its constitution, a mutual benefit society, it was not governed by the* Mylapore Fund Case *and its income was not exempt from tax* : (ii) *that the company was not entitled to claim in computing its assessable income, a deduction of the amount paid to its shareholders and subscribers in excess of their contributions*

under Sec. 10 (2) (iii) *of the Act inasmuch as the sums so paid were not in the nature of interest on borrowed capital but were in the nature of dividends dependent on the earning of profits*; (iv) *that the fact that the company was not assessed for the years 1927-28 to 1930-31 could not operate as* res-judicata *and did not prevent the company from being assessed in subsequent years*; *and* (v) *that the assessment under Sec. 34 for the year 1930-31 was valid.*

Cases referred to:

BOARD OF REVENUE *v.* MYLAPORE HINDU PERMANENT FUND [1923] (I.L.R. 47 Mad. 1; 1 I.T.C. 217; 76 I.C. 833; A.I.R. 1923 M. 684).

LEEDS PERMANENT BENEFIT BUILDING SOCIETY *v.* MALLANDAINE [1897] (1897, 2 Q.B. 402; 66 L.J.Q.B. 813; 3 Tax Cas. 577).

TRICHINOPOLY TENNORE HINDU PERMANENT FUND *v.* COMMISSIONER OF INCOME TAX, MADRAS [1927] (2 I.T.C. 386; 53 M.L.J. 881; 106 I.C. 621; A.I.R. 1927 Mad. 1076).

Case stated by the Commissioner of Income Tax, Madras, under Sec. 66 (3) of the Indian Income Tax Act, (XI of 1922). O.P.No. 173 of 1936.

CASE.

"In accordance with the High Court's order quoted above, I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Sec. 66 (3) of the Indian Income Tax Act, (XI of 1922) hereinafter referred to as the Act.

2. The reference arises out of the assessment of the Trichinopoly Tennore Hindu Permanent Fund Ltd., (hereinafter referred to as the Fund) for the year 1930-31.

3. The fund is a Company incorporated under the Indian Companies Act, VI of 1882 (now Act VII of 1913). Its nominal capital was originally Rs. 2,99,970 made up as follows:—

(i) 1800 fully paid-up permanent shares of Rs. 50 each amounting to Rs. 90,000.

The objects of the Fund according to its Memorandum of Association were:

(*a*) to enable persons to save money,

(*b*) to enable persons to secure loans at favourable rates of interest on sufficient securities, and

(*c*) to do such other things as were incidental or conducive to the attainment of the above objects.

4. In the assessment year 1925-26, the Fund was treated as an ordinary banking concern and its profits as shown in its Profit and Loss account were taxed. Its contention that it was a mutual benefit society and was therefore entitled to the benefit of the ruling of the Madras High Court in *Board of Revenue* v. *Mylapore Hindu Permanent Fund Ltd.*, was not accepted. The High Court to whom a reference was made on this point upheld the view of the department: (See 2 I.T.C. 386). This decision was followed in the assessment made for 1926-27. In 1926, however, the Fund amended its Memorandum of Association by substituting the word "members" for "persons" in clauses (a) and (b) quoted above and restricted its transactions to its "members." The contention was thereupon raised for a second time that the Fund should be treated as a mutual benefit society. On the basis of the amendment of the Memorandum of Association the Income tax Officer accepted this contention and accordingly made no assessment on the income of the Fund from 1927-28 to 1930-31. In December 1931, the Income Tax Officer took a different view and considered that the Fund was assessable on its entire profits. He accordingly proceeded to assess the petitioner Fund on this basis for 1931-32 and also initiated proceedings under Sec. 34 to assess the income of the year 1929-30 that had escaped assessment in 1930-31. It is against the assessment made in these proceedings for 1930-31 that the petitioner Fund has raised certain questions of law which form the subject matter of this reference.

5. Here it is necessary to set out the constitution of the Fund after the amendment of 1926. The capital of the Fund has been raised to Rs. 9,90,000 divided into 7 classes of shares as under:—

(*a*) 1800 fully paid up "Permanent" shares of Rs. 50 each amounting to	Rs. 90,000
(*b*) 2120 "Original" term shares of Rs. 90 each payable in 45 consecutive monthly calls of Rs. 3 amounting to	,, 1,90,800
(*c*) 400 "A" class term shares of Rs. 93 each payable in 31 consecutive monthly calls of Rs. 3 amounting to	,, 37,200
(*d*) 2880 "B" class term shares of Rs. 90 each payable in 45 consecutive monthly calls of Rs. 2 amounting to	,, 2,59,200
(*e*) 4600 "C" class term shares of Rs. 83 each payable in 83 consecutive monthly calls of	

Re. 1 amounting to	,, 3,81,800
(*f*) 500 "Reserve" shares of Rs. 53 each payable in 10 calls of Rs. 5 each, Rs. 5 on application and the remaining calls whenever required on not less than 1 month's notice amounting to	,, 25,000
and	
(*g*) 6000 " ordinary " shares of Re. 1 each fully paid up amounting to	,, 6,000
	Rs. 9,90,000

(" A " class shares were to be gradually eliminated by absorbing them as they matured).

A copy of the Memorandum and Articles of Association is appended marked Exhibit A. Holders of "Permanent", "Reserve", and " Ordinary " shares are styled " shareholders " and holders of " Original " and " A ", " B " and " C " class term shares are called " subscribers ". The term " members " applies to both shareholders and subscribers (Article 8). No one shall have any dealings with the Fund unless he is the holder of a share (Article 9). " Permanent " and Reserve" shares are only transferable but not withdrawable except as provided in Article 24; whereas ordinary shares are not transferable but are withdrawable after 2 years or at any time thereafter. The " original " and " A ", " B " and " C " class term shares are transferable or withdrawable or terminable at the close of the term of 45, 31, 45 and 83 calendar months as the case may be (Article 7). Byelaw 1 under Article 9 allows Companies and Institutions, charitable or otherwise to take shares in the Fund. Article 28 authorises the managing committee to raise debenture capital in the shape of emergent debts or deposits or receive for safe custody moveable property or cash as Trust on such terms as may be defined in the byelaws. Article 31 specifies the kinds of deposits which the Fund is authorised to accept, viz., (1) Security deposits for office bearers and staff, (ii) Fixed deposits and (iii) Current deposits. The Fund grants loans to its members on the following 4 classes of securities (Article 37): 1. Cash security, 2. Moveable security, 3. Immoveable security, and 4. Personal security. Loans are of two kinds, term loans (granted to "subscribers" only) and temporary loans (granted to all "members").

(*a*) Term loans on cash security are granted up to 95 per

cent. of the amount paid up by the applicant as monthly subscriptions. Term loans on other securities will be granted up to a maximum of Rs. 100 for each term share held by the applicant (Article 41).

(b) Temporary loans on each security will be granted up to 75 per cent of the amount paid up by the applicant as share value on Permanent and Reserve shares and up to 95 per cent of the amount paid up as monthly subscription on term shares and fixed deposits.

6. The accounts of the Fund are closed at the end of every 9 calendar months and a balance sheet and profit and loss account prepared. The interest recovered, the entrance fee, the transfer on decree dues not recovered, the entrance fee, the transfer fee, the trust fee, the substitution fee, contribution to revenue from the revaluation fee and other such items of income constitute the gross profit of the fund in each period (Article 49). All items of expenditure such as cost of establishment, taxes, interest on all kinds of deposits, provident fund emergent debts, etc., postage, printing and other office expenses are deducted from the gross profit and the balance is the net profit for the period. The net profit realised in each period is distributed in the following proportions:—

83 per cent towards dividends to " shareholders " and " subscribers " calculated on a standard basis of 9.5 per cent to permanent shares, 7.25 per cent to Original terms shares and 6.25 to " A ", " B " and " C " class Term shares, Reserves shares and Ordinary shares per annum on the respective amounts of average capital at their credit at the close of the period, 16.4 per cent towards remuneration of directors; and the remaining 0.6 per cent to Reserve Fund and Charity Fund (Article 55).

Dividends are not payable except out of the net profits arising from the business of the Fund. Dividends to " shareholders " are paid soon after the Balance sheet is passed by the General Body; but those payable to the "subscribers" are credited to their accounts and are paid only at the close of the terms provided they have continued as subscribers to the end of such term. (Byelaw 1 under article 55). Article 61 and the byelaws thereunder provide that every " member " of 90 days standing having one permanent share, or 10 reserve shares, or 50 ordinary shares, or 3 original term shares or 10 " A " class or 15 " B " class or 30 " C " class term shares shall have a vote irrespective of the number of shares held by him.

7. The following statement shows the number of shareholders in each class qualified to vote, the nature of the paid up capital

on 31st March 1930, the income realised from each class of shareholders and the nature and disposal of the profit for the period of 9 months ended 31st March 1930 :—

Number and Nature of shares subscribed.	Amount paid on account of capital.	Interest collected on the loan advanced.	Dividend payable out of the net profits.	No. of share-holders qualified to vote.
1800 permanent shares ...	90,000	1,843-7-7	6,542-2-6	140
66 Reserve shares ...	330	306-13-8	15-12-6	2
2970 Ordinary shares formerly outsisiders ...	2,970	14,217-13-9	139-11-4	1
20 Original Terms shares.	94,172	5,118-6-11	5,550-9-5	220
10 "A" class Terms shares.	795	36-12-1	141-6-0	Nil.*
1997 "B" class Term shares.	82,018	3,615-14-10	3,660-5-9	27
1664 "C" class Term shares.	67,884	8,815-2-10	3,338-9-5	7
Total ...	3,38,169	33,954-7-8	19,388-8-11	

* A class Term shares have been eliminated.

Remuneration to Directors	...	3,830-15-10
Amount carried to Reserve and Charity Funds	...	140-2-7
Net profit According to the Profit and Loss Account for 9 Months ended 31st March 1930	...	23,399-11-4

8. In compliance with the notice under Sec. 34 the Fund returned an income of Rs. 24,700 for the tax year 1930-31. The Income-tax Officer examined the accounts and determined its total income to be Rs. 24,458. The Fund accepted the basis of computation of the income; but objected to be assessed on it on the ground that it was a mutual benefit society dealing only with its members and as such was not liable to be assessed. Having regard

to the actual constitution and working of the Fund the Income tax Officer overruled the objection and assessed the Fund on Rs. 24,458.

9. In its appeal to the Assistant Commissioner the Fund contended

(i) that it was a mutual benefit society deriving income from transactions with its members and that therefore it was exempt from taxation in accordance with the ruling in the *Mylapore Fund's Case*,

(ii) that the Income-tax Officer was bound by the rule of *res judicata* and was estopped from coming to a decision in regard to the assessment of 1930-31 different from that arrived at in connection with the previous assessments and that Section 34 was inapplicable, and

(iii) that the amount distributed to the share-holders should be treated like "guaranteed interest" in the *Madura Fund case* and should therefore be allowed as a charge in computing the assessable income.

On the first contention the Assistant Commissioner held that the Fund was not a mutual benefit society for the reason that there were different classes of members with different kinds of liabilities and rights and that mutuality implied equal participation in the benefits and liabilities. He also overruled the other two contentions for the reasons stated in his order. On other grounds he enhanced the assessment of Rs. 24,995. A copy of his order is appended marked Ex. B.

10. The petitioner Fund then filed an application under Sec. 66 (2) of the Act and required me to state a case and refer six questions for the decision of the High Court. My predecessor considered that the alterations made in the constitution of the Fund in 1926 after the High Court's decision in the case of this Fund (2 I.T.C. 386) did not convert it into a mutual benefit-society entitled to the benefit of the ruling in the *Mylapore Fund case*. He therefore declined to state a case. A copy of his order is appended, marked Ex. C.

11. **Questions referred :**—The Fund thereupon moved the High Court under Sec. 66 (3) of the Act and the High Court has by its order dated 18th November 1936 directed me to state a case and refer the following five questions :

(i) Whether the assessment of the petitioner to income-tax upon a sum of Rs. 24,995 for the year 1930-31 is valid and maintainable ;

(ii) Whether the present case is not governed by the decision in *47 Madras 1* and whether the petitioner is not therefore liable to pay income-tax.

(iii) Whether the petitioner is not entitled to claim in computing the assessable income a deduction of the amount paid to the shareholders and subscribers in excess of their contributions as being interest on borrowed capital within Section 10 (2) (iii) of the Act;

(iv) Whether the Income tax authorities are precluded in law from levying income tax on the petitioner having regard to the fact that the petitioner was recognised and treated by them as a mutual benefit society and exempted from payment of income tax since the year 1927, and

(v) Whether the assessment of the petitioner for the year 1930-31 under Section 34 of the Act is valid and maintainable."

12. **Opinion of the Commissioner.** *Questions (i) and (ii).* These two questions may be considered together as they appear to raise the same point, *viz.*, whether the petitioner Fund is a mutual benefit society or not. This point came up for consideration before the High Court in 1926 and it was then held that the constitution of the Fund differed fundamentally from that of the New York Life Insurance Co., Ltd. or the Mylapore Hindu Permanent Fund and that the claim of the Fund that it was entitled by virtue of the ruling in those cases to be exempt from taxation in regard to any of its profits could not be sustained. The Fund now contends that it has altered its constitution so as to restrict its transactions to " members " to the exclusion of outsiders, and that it is therefore a mutual benefit society. The alleged change in the constitution is indicated by the substitution of the word " members " for the word " persons " in clauses (a) and (b) in the Memorandum of Association to which reference has been made in paragraph 4 above. It will be seen that under the altered constitution there is a class of " ordinary " shareholders who became members on payment of a nominal fee of Re. 1 which is withdrawable. Out of the Fund's total paid up capital of Rs. 3,38,169 on 31st March 1930, the amount contributed by these " members " is Rs. 2,970 while the interest collected from them on the loans granted to them during the nine months ending 31st March 1930 is Rs. 14,217 out of a total collection of Rs. 33,954 during the same period. The " dividend " distributed to them is only Rs. 139 out of a total of Rs. 19,388. These figures throw considerable light on the status of these ordinary shareholders in relation to the Fund. The " capital "

contributed by them is so small as to suggest that it is something in the nature of a nominal entrance fee. The transactions of the Fund with them are similar to those with the "depositors" under the old constitution. I consider that there is no element of mutuality so far as the transactions of the Fund with these "members" are concerned. This feature distinguishes the petitioners Fund altogether from those of the type of the Mylapore Hindu Permanent Fund. Another point of difference is that this Fund has shares which are not ordinarily withdrawable, viz., the "permanent" and "Reserve" shares, and are similar to the shares of an ordinary banking company. The net profit of the Fund is determined as in the case of an ordinary banking company and dividends are paid only out of such "net profits". Nothing is "guaranteed" as in the case of the Mylapore Fund. All these circumstances go to show that the alterations made in the constitution of the Fund have not in fact converted it into a mutual benefit society entitled to the benefit of the ruling in the *Mylapore Fund case.* The entire profits of Rs. 24,995 have therefore been rightly taxed. The questions should be answered accordingly.

Question (*iii*). There is no payment of interest to the shareholders or subscribers on the capital subscribed by them. The fund pays dividends to its members and these are dependent on the earning of profits. The sums so paid are not in the nature of interest on borrowed capital which is allowable under Sec. 10 (2) (iii) of the Act. Petitioners are not, in my opinion, entitled to claim a deduction of these sums.

Question (*iv*). An Income tax Officer is not a Court, and the doctrine of *res judicata* has no application to his decisions. Nor am I aware of any other legal principle which could possibly require him, having come to a wrong decision in regard to a particular assessment to repeal that wrong decision in every subsequent assessment made on the same party. The word "exempted" is used in the question; but an Income tax Officer has no power to confer exemptions. These are created by statute, or by the Governor-General in Council by virtue of his power under Sec. 60 (1) of the Act. An Income tax Officer's function is to ascertain the liability afresh each year, and his decision in one year cannot bind him or his successor in a later year. I am of opinion that the question should be answered in the negative.

Question (*v*). The suggestion appears to be that if income is chargeable, but is not charged owing to the fact that the Income tax Officer came to a wrong decision, then it has not "escaped

assessment" within the meaning of Sec. 34. The point is covered by the decision of this Court in the case of the *Raja of Parlakimidi*, printed at page 104 of II I.T.C. The question should in my opinion be answered in the affirmative."

The case was heard by Leach, C. J., Varadachariar, J., and King, J.

N. Srinivasa Ayyangar, for the assessee.

M. Patanjali Sastri, for the Commissioner.

JUDGMENT.

The real question involved in this reference is whether the Trichinopoly Tennore Hindu Permanent Fund Ltd., a company registered under the Indian Companies Act, is a banking concern or a mutual benefit society. The question was raised on a former occasion, namely, in respect of the income tax year 1925 26. The income-tax authorities then treated the Company as an ordinary banking concern and taxed it on that basis. At the instance of the Company the question was referred by the Commissioner of Income tax to this Court which decided that the Income tax authorities had taken the correct view. (*The Trichinopoly Tennore Hindu Permanent Fund Ltd.* v. *The Commissioner of Income Tax, Madras*, 2 Income tax Cases 386). After this decision had been given, the company took steps to alter its memorandum and articles of association. In the original memorandum the objects of the company were stated to be:—"(a) to enable persons to save money; (b) to enable persons to secure loans at favourable rates of interest on sufficient securities; and (c) to do all such other things as are incidental or conducive to the attainment of the above objects". For the word "persons" the word "members" was substituted. The company had made considerable profits out of lending money to non-members and this was the reason for the decision that the company was a banking concern and not a mutual benefit society.

The nominal capital was originally Rs. 2,99,970 made up as follows:—(1) 1,800 fully paid-up permanent shares of Rs. 50 each, amounting to Rs. 90,000, (2) 2,333 term shares of Rs. 90 each payable in 45 monthly instalments of Rs. 2 amounting to Rs. 2,90,970. After the alteration of the memorandum and the articles of association, the nominal capital of the company was Rs. 9,90,000 divided into seven classes of shares, namely:—

	Rs.
(a) 1,800 fully paid up "Permanent" shares of Rs. 50 each amounting to	90,000

(b) 2120 " Original " term shares of Rs. 90 each payable in 45 consecutive monthly calls of Rs. 2 amounting to ...	1,90,800
(c) 400 "A" class term shares of Rs. 93 each payable in 31 consecutive monthly calls of Rs. 3 amounting to ...	37,200
(d) 2880 " B ', class term shares of Rs. 90 each payable in 45 consecutive monthly calls of Rs. 2 amounting to ...	2,59,000
(e) 4600 "C" class term shares of Rs. 83 each payable in 83 consecutive monthly calls of Re. 1 amounting to ...	3,81,800
(f) 500 "Reserve" shares of Rs. 50 each payable in 10 calls of Rs. 5 each, Rs. 5 on application and the remaining calls whenever required on not less than 1 month's notice, amounting to ...	25,000
(g) 6000 "Ordinary " shares of Re. 1 each fully paid up amounting to ...	6,000
	9,90,000

A person who required a loan had under the altered articles to become a member, but he could become a member on payment of one rupee, which he was entitled to withdraw at the end of two years. In passing I should mention that it is conceded that the ordinary shares have been issued to persons who under the former scheme would have been non-member borrowers. After the memorandum and the articles had been altered, the company contended that it was in fact a mutual benefit society, and therefore, its income was not taxable. The contention was accepted for the years 1928-29, 1929-30 and 1930-31, but in respect of the 1931-32 assessment the income-tax authorities reconsidered the question and came to the conclusion that the company was in reality still a banking concern. In accordance with this decision they reopened the assessment for the year 1930-31. In respect of the year 1930-31 the Income tax Officer assessed the company on an income of Rs. 24,458 which was subsequently enhanced to Rs. 24,995. Thereupon the company asked the Commissioner of Income tax to state a case to this Court under the provisions of Sec. 66 of the Act, but the Commissioner declined to do so. An application was then made under Sec. 66 (3) of the Act to this

Court and the Commissioner was directed to state a case on the following questions:—

(i) Whether the assessment of the Petitioner to income-tax upon a sum of Rs. 24,995 for the year 1930-31 is valid and maintainable?

(ii) Whether the present case is not governed by the decision in *47 Madras 1* and whether the petitioner is not therefore liable to pay income-tax?

(iii) Whether the petitioner is not entitled to claim in computing the assessable income a deduction of the amount paid to the share-holders and subscribers in excess of their contributions as being interest on borrowed capital within Sec. 10 (2) (iii) of the Act?

(iv) Whether the Income-tax authorities are precluded in law from levying income tax on the petitioner having regard to the fact that the petitioner was recognised and treated by them as a mutual benefit society and exempted from payment of income tax since the year 1927?

(v) Whether the assessment of the Petitioner of the year 1930-31 under Sec. 34 of the Act is valid and maintainable?

It will be convenient to take questions (i) and (ii) together. The case referred to in 47 Madras 1 is that of the *Board of Revenue* v. *The Mylapore Hindu Permanent Fund Ltd.* There the capital of the society was made up solely of periodical investments by its members and the income of the society was mainly derived from interest on loans given to its members, every one of whom was by the rules eligible to take loans. It was held that such income did not constitute "profits" within the meaning of the Income-tax Act, 1918. The Trichinopoly Tennore Hindu Permanent Fund Ltd., however, differs in material respects from the Mylapore Hindu Permanent Fund Ltd. The company obtained, as I have already mentioned, considerable income from loans to non-members. No doubt it now only gives loan to persons who become "members," but it is said that the membership is in many cases merely nominal and that the company carries on in reality the same business as it did before the memorandum and the articles of association were altered. It appears to us that there is much substance in this contention.

A person who wants a loan can obtain one from this company, if he pays one rupee for a share, and he is entitled to have that one rupee paid back to him at the end of two years. Out of a

gross income of Rs. 33,954-7-8 for the nine months ended 31st March 1930, a sum of Rs. 14,217-13-9 represented interest on loans granted to persons who had each acquired an ordinary share of one rupee and only Rs. 139-11-4 was paid to these persons by way of dividend. The holders of permanent shares received in dividends Rs. 6,542-2-6, the holders of original term shares Rs. 5,550-9-5, the holders of "B" class term shares Rs. 3,660-5-9 and the holders of "C" class term shares Rs. 3,338-9-5. In other words, the large profits which the company made were distributed to its real shareholders. The nominal members, those who had taken one rupee shares, invested practically nothing and consequently nothing was paid to them out of the profits either by way of dividend or in reduction of interest. By borrowing from the company they made for the company large profits, in which they were not allowed to share. In the circumstances it is impossible for the company to contend that it is a mutual benefit society and its income is not taxable.

A very similar question to the one which arises was dealt with in the case of *The Leeds Permanent Benefit Building Society* v. *Mallandaine* (1897, 2 Q.B. page 402). This society consisted of members who held one or more shares or one or more fifth parts of a share and the shares were divided into two classes: (i) investors' shares and (ii) borrowers' shares. The members were divided into classes according to the shares they held. The society lent money to its members at a fixed rate of interest. The payment of the loans was by weekly payments of a fixed sum, which covered both principal and interest. No deduction was allowed by the Income-tax authorities to be made by the borrower in respect of income-tax and the society was assessed on the interest it received as being interest on money within Sec. 2 of the Income-tax Act, 1853. On a case being stated it was held that the expression "interest of money" in Sec. 2 of that Act was not restricted to annual interest and that the interest received by the society was not in respect of a loan on land, but of a contract relating to interest on money lent, and was therefore, assessable in their hands to income-tax. In the case before us likewise borrowers become members, but the holders of ordinary shares are members in name only. Their membership does not in any sense give them the benefits of membership of a mutual benefit society. Therefore, we consider that the answer to Question No. (i) should be in the affirmative and the answer to Question No. (ii) should be that it is not governed by the *Mylapore Fund case.*

The answer to Question No. (iii) has been correctly stated by the Commissioner of Income-tax in his reference. He points out that there is no payment of interest to shareholders or subscribers on the capital subscribed by them. The company pays dividends to its members and these are dependent on the earning of profits. The sums so paid are not in the nature of interest on borrowed capital, which is allowable under Sec. 10 (2) (iii) of the Act. The company, is, therefore, not entitled to claim a deduction in respect of these sums.

Questions (iv) and (v) can also be taken together. What is really contended for here is that the doctrine of *res judicata* operates in respect of an assessment made by an Income-tax Officer. This is clearly erroneous. The Income-tax Officer does not constitute a Court, and, therefore, the doctrine can have no application. But his assessments are final, unless they can be reopened under some provision of the Act. Consequently, the answer to the Question No. (iv) is in the negative and the answer to the Question No. (v) is in the affirmative.

As the reference has been answered in favour of the Commissioner of Income-tax he will be entitled to costs, which we fix at Rs. 250.

Reference answered accordingly.

[IN THE BOMBAY HIGH COURT.]

DWARAKANATH HARISCHANDRA PITALE AND ANOTHER, *In re.*

SIR J. F. BEAUMONT, C. J., and BLACKWELL, J.

September 27, 1937.

CO-OWNERS—PERSONS INHERITING IMMOVEABLE PROPERTY IN EQUAL SHARES UNDER WILL AND JOINTLY MANAGING IT—WHETHER ASSESSABLE AS "ASSOCIATION OF INDIVIDUALS"—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 3, 9 (1).

The assessees, two brothers, became entitled to certain house properties 'as tenants-in-common in equal shares' under the will of their grand-father, and from 1929 they held and managed the properties as joint owners and derived profit therefrom. The net income after defraying the expenses was equally divided between them. The assessees were, however, jointly assessed on the aggregate rental value as an association of individuals :

Held, *that, though the assessees in the first instance did not constitute an association of individuals, they became an association of individuals within the meaning of Sec. 3 of the Income-tax Act when they elected to retain the property and manage it as a joint venture producing income; that the said association was the owner of the properties within the meaning of Sec. 9 of the Indian Income-tax Act and was rightly assessed as such; that, in any event, the assessees were rightly assessed as owners of the properties under Sec. 9 (1) of the Act.*

B. N. Elias, In re (1935 I.T.R. 408) and *Commissioner of Income Tax, Bombay* v. *Lakhmidas Devidas (1937 I.T.R. 584)* followed.

Cases referred to:

B. N. ELIAS, In re [1935] (I.L.R. 63 Cal. 538; 1937 I.T.R. 408; 40 C.W.N. 476; 9 I.T.C. 1).

COMMISSIONER OF INCOME TAX, BOMBAY *v.* LAKHMIDAS DEVIDAS [1937] (1937 I.T.R. 584; 39 Bom. L.R. 910).

Case stated by the Commissioner of Income Tax, Bombay, under Sec. 66 (2) of the Indian Income Tax Act, (XI of 1922) in the matter of the assessment of Messrs. Dwarkanath Harishchandra Pitale and Chandrakant Harishchandra Pitale of Bombay, for the year 1936-37.

STATEMENT OF CASE.

"Under Sec. 66 (2) of the Income-tax Act (hereinafter referred to as the "Act'), and at the instance of Messrs. Dwarkanath Harishchandra Pitale and Chandrakant Harishchandra Pitale of Bombay (hereinafter referred to as the "assessees"), I have the honour to refer for your Lordships' decision, the questions of law set out in paragraph 6 below, which have arisen out of the income-tax assessment of the assessees for the financial year 1936-37 ending on 31st March 1937.

2. **Facts of the Case**:—The assessees are two brothers Dwarkanath Harishchandra Pitale and Chandrakant Harishchandra Pitale. They became entitled as residuary legatees under the will of their grand-father to certain house properties in Bombay city of the aggregate annual rental valuation of Rs. 25,000. These were at first managed by one Mr. Khanderao Narayan as Executor of the said will but were ultimately handed over to the assessees under a deed of release, dated 28th January 1929, from which the following is a relevant extract:—"To have and to hold the said several

lands, hereditaments and premises and all and singular the premises duly granted, conveyed and assured or intended so to be with their and every of their rights, members and appurtenances unto and to the use of the transferees and their respective heirs, executors, administrators or assigns as tenants-in-common in equal shares subject nevertheless to the payment of all rents, assessments due and duties to be hereafter chargeable upon the same or which may hereafter become payable in respect thereof." From the time they were then put in possession, the assessees have been holding the properties jointly and managing them jointly. The net income earned after paying all expenses of management and municipal taxes, etc., is divided between them. As in his appellate order, the Assistant Commissioner has not arrived at any definite finding on these facts, I have gone through all the relevant papers and arrived at the above finding which supports the story of the assessee as put forward for the purpose of the assessment in dispute. As the assessees will base their arguments on the above facts, I have taken the liberty of placing the above finding before the Honourable Court as regards the history of the acquisition of these properties by the assessee.

3. For the purpose of their assessment for the financial year 1936-37 (ended on 31st March 1937), the Income-tax Officer, D. Ward, Section II, issued a notice under Sec. 22 (2) of the Act in the name of Messrs. Dwarkanath Harishchandra Pitale and Chandrakant Harishchandra Pitale calling upon them to put in a return of their income. A return was accordingly put in signed by both the brothers and dated 14th August 1936, declaring net income of Rs. 20,238 from the said properties and dividends from joint stock companies and stating in the margin that it was equally divided between them. The Income-tax Officer, after hearing the assessees' representative decided to assess them jointly as an association of individuals following the decision of the Calcutta High Court in the case of *Messrs. B. N. Elias & Co.* A copy of his assessment order dated 24th August 1930 is annexed hereto and marked Exhibit A.

4. Being dissatisfied with the above assessment the assessees applied to the Assistant Commissioner of Income-tax under Sec. 30 of the Act by their petition dated 25th September 1936, of which a copy is annexed hereto and marked Exhibit B. The Assistant Commissioner, by his order dated the 20th October 1936 upheld the assessment order. A copy of the appellate order and grounds of decision is annexed hereto and marked Exhibit C.

5. As the Assistant Commissioner did not grant their prayer for separate assessments, the assessees made a petition to me dated 21st November 1936 (copy whereof is annexed hereto and marked Exhibit D) requiring me to revise the appellate order under the powers vested in me under Section 33 of the Act or in the alternative refer the case to your Lordships. As I am unable to grant any relief I submit this Statement of Case for favour of your Lordships' decision.

9. **Questions for the decision of the Honourable Court** :—I submit the following questions for decision by the Honourable Court :—

" (1) Whether in the circumstances of the case the assessees constituted in law an association of individuals within the meaning of Section 3 of the Indian Income-tax Act?

(2) Whether the said association can be said to be the owner of the properties within the meaning of Section 9 of the Income-tax Act and was rightly assessed as such ?

(3) Whether the assessees were in any event rightly assessed as owners of the said properties under Section 9 (1) of the Act ? "

7. **Opinion of the Commissioner** :—As Section 66 (2) of the Act requires me to give my opinion while submitting this Statement of the Case, I submit respectfully that the answers to the above questions should be in the affirmative. Section 9 (1) of the Act clearly lays down that "tax shall be payable by an assessee under the head 'Property' in respect of the *bona fide* annual value of the property consisting of any buildings or lands appurtenant thereto of which he is the owner ". That this is income chargeable under the head " Property " is undisputed. Hence tax on the annual value of the property must be levied on the income thereof as laid down in the said Sec. 9 (1) of the Act. The only question for decision is " who is the owner of the properties ? " On the facts found, namely, that the assessees inherited the property jointly from their grand-father for the purpose of holding and using the same in order to acquire profit or gain and remained united with each other as owners of the said property managing them jointly, collecting the rents jointly, and paying the expenses jointly, it is submitted that it was incumbent on the Income-tax Officer to assess them as an association of individuals owning the properties. Section 9 refers to " annual value of property consisting of any building or lands appurtenant thereto " and it is submitted that there can be no such thing as the annual value of an undivided ½ part of a building and that the section on the face of it does not contemplate any division

of a building into separate parts for assessment purposes of anything of the kind. Neither Mr. Dwarkanath Harischandra Pitale nor Chandrakant Harischandra Pitale is by himself the owner of the properties in question. The two combined jointly own them within the meaning of Section 9 and that section clearly provides that " tax shall be payable by the assessee who is the owner ", *viz.*, the above two persons jointly.

8. The words used in Section 9 (1) are " the tax payable by an assessee......" and indeed the section is, as above suggested, itself a charging section in respect of the particular kind of income therein referred to, namely, property.

9. Turning, however, to the main charging section, *viz.*, Section 3, under it, tax is charged on every individual, Hindu Undivided family, company, firm or any other association of individuals ". The words " any other association of individuals " mean an association which is neither a Hindu undivided family nor a company nor a firm and the words appear clearly to include persons associating together for acquiring, holding and managing jointly house property for earning income therefrom. Hence even under Section 3 the assessment is un-objectionable. The Calcutta High Court case of *Messrs. B. N. Elias and others* (I.L.R. 63 Calcutta 538) on which the Income-tax Officer relied, was, it is submitted correctly decided.

10. A copy of your Lordships' decision may kindly be certified to me for further action as required by Sec. 66 (5) of the Act."

M. C. Setalvad with *G. B. Gupte* and *Nanu Hormusji & Co.*, for the assessees.

The *Advocate-General* with the *Government Solicitor*, for the Crown.

JUDGMENT.

BEAUMONT, C. J.—This is a reference made by the Commissioner of Income-tax under Section 66 (2) of the Indian Income-tax Act. and the questions raised are :—

"(1) Whether in the circumstances of the case, the assessees constituted in law an association of individuals within the meaning of Section 3 of the Income-tax Act ?

(2) Whether the said association can be said to be the owner of the properties within the meaning of Section 9 of the Income-tax Act and was rightly assessed as such ?

(3) Whether the assessees were in any event rightly assessed as owners of the said properties under Sec. 9 (1) of the Act ? "

The facts found are that the assessees became entitled as residuary legatees under the will of their grand-fathers to certain house properties in the city of Bombay of the aggregate rental value of Rs. 25,000. They so became entitled in the year 1929, when the properties were handed over to them, and they have since managed the properties as joint owners and derived profit therefrom. I think this case is really governed by the decision of this Court in *Commissioner of Income Tax, Bombay Presidency, Sind and Aden* v. *Laxmidas Devidas* (1937, 39 Bombay Law Reporter 910) in which we held, following the principle laid down by the Calcutta High Court in *In re B. N. Elias*, (1935 I.L.R. 63 Calcutta 538), that two persons who had purchased property and managed it for the purpose of producing income were properly assessed as an association of individuals under Sec. 3 of the Indian Income tax Act. The only distinction between that case and the present one is that the original association in the present case was not a voluntary act on the part of the assessees. They did not purchase the property for the purpose of managing it; they received it under a will, and it may be said, that in the first instance they did not constitute an association of individuals. But as soon as they elected to retain the property and manage it as a joint venture producing income, it seems to me that they became an association of individuals within the meaning of the Income tax Act, and that they are properly assessed as the owners of the property under Sec. 9. In my opinion, therefore, the questions must all be answered in the affirmative. The assessees to pay the costs of the Commissioner on the Original Side scale to be taxed by the Taxing Master, less the deposit of Rs. 100.

BLACKWELL, J.—I agree. *Reference answered.*

[IN THE NAGPUR JUDICIAL COMMISSIONER'S COURT.]

AMRIT WAMAN v. COMMISSIONER OF INCOME TAX, C. P. AND U. P.

SUBHEDAR and GRUER, A. J. Cs.

January 4, 1936.

ACCOUNTING—MERCANTILE SYSTEM—ASSESSMENT OF ACTUAL RECEIPTS ALONE FOR SEVERAL YEARS—ASSESSEE REQUESTING ASSESSMENT ON MERCANTILE BASIS—APPLICABILITY OF PARA. 51, INCOME TAX MANUAL—POWER TO ASSESS INTEREST OF PREVIOUS

Years Which Had Escaped Assessment—Indian Income Tax Act (XI of 1922), Sec. 13—Income Tax Manual, Para 51.

The assessee who carried on money lending business maintained his account in the mercantile system showing interest as received whenever the account of a debtor was settled, interest was received in cash or a bond was renewed. All these receipts were treated on the same footing till the decision of the Nagpur Judicial Commissioner's Court in Sir S. M. Chitnavis *v.* Commissioner of Income tax C. P. (*3 I.T.C. 321*). *In this case it was held that sums entered as credits on account of interest accrued due but not realised and re-entered as debits could not be treated as 'income' for purposes of taxation. Accordingly in the assessments for the years 1928-29 to 1932-33 income tax was levied on the basis of interest actually received. In 1933-34, the assessee requested the income tax authorities to assess him on the basis of the mercantile system and not on cash basis and the income tax officer agreed provided 'the assessee agreed to accept assessment of the income that had escaped assessment according to mercantile system in the* Sambat *years 1983, 1984, 1986 and 1987, on account of the change in accounting system to cash basis.' The assessee agreed if he was allowed to pay in instalments but the income tax officer assessed the entire interest which has escaped according to him from 1983 to 1987. The legality of this assessment was questioned by the assessee.*

Held, (*i*) *that on the facts of the case there was no unqualified acceptance on the part of the assessee to the Income Tax Officer's proposal*; (*ii*) *as the assessee's accounts were throughout maintained on the mercantile system, para 51 of the Income tax Manual had no application to the case*; (*iii*) *the Income Tax Officer had no jurisdiction to re-open the previous five years' accounts and assess interest which had not been assessed in those years in accordance with the ruling referred to above.*

Case referred to:

Sir S. M. Chitnavis *v.* Commissioner of Income Tax, C. P. [1929] (25 N.L.R. 35; 3 I. T. C. 321; 117 I.C. 258; A.I.R. 1929 Nag. 50).

W. B. Pendharkar, for the Assessee.

D. N. Choudhary, for the Commissioner of Income tax.

JUDGMENT.

The Commissioner of Income tax, Central and United Province, has referred, under Sec. 66 (2) of the Indian Income tax Act, XI of 1922, the following single question of law for decision

although it embraces the first seven questions formulated by the assessee in his application to the Commissioner (Appendix G) :—

"The assessee having accepted in principle the conditions for the change in the system of accounting for the purposes of his income tax assessment, was the Income tax Officer justified in assessing as the income, profits or gains of the account year the amount of Rs. 23,043, the interest for years anterior to the year of account irrespective of the question whether and what part of the amount has been received in cash and what part constructively, when such interest had not been taxed at any time in former years ? "

2. The assessee carries on money-lending business in the Buldana district and his account year is the Diwali year and the accounts for the assessment year in dispute (1933-34) cover the year ending with Diwali of Samwat 1988. The assessee has been maintaining his accounts on the Mahajani or mercantile system which shows interest as received (1) whenever the account of a debtor is settled, or (2) interest is received in cash or (3) a bond is renewed. In cases (1) and (3) interest is debited to the debtor's account and credited to the interest account in the same way as in case (2). In other words, in cases (1) and (3) constructive receipts were treated on the same footing as actual receipts until the decision of this Court in *Sir S. M. Chitnavis* v. *The Commissioner of Income Tax, Central Provinces,* where it was held that sums entered as credits on account of interest accrued due but not realised and re-entered as debits in the assessee's account books in order to equalise the side of the account of a debtor could not be treated as 'income' coming into the hands of the assessee for the purpose of the income tax. Accordingly in the assessments on income for the years 1928-29 to 1932-33 both inclusive the income tax authorities made the assessment on the basis of interest actually received by the assessee though he was ordered to submit a separate list of interest credited in the manner laid down at (1) and (3) above.

3. In the assessment year 1933-34 the assessee returned his income of the previous year accompanied by a profit and loss account on the basis of the Mahajani or mercantile system and requested the Income tax Officer to base the assessment on that system of accounting and not on the cash basis system which the Income tax authorities had adopted during the past five years. On this the Income tax Officer on 10-3-1934 proposed to revert to the mercantile system for the purposes of assessment provided the assessee agreed "to accept assessment of the income that escaped assessment according to mercantile system in Samwat years 1983,

1984, 1986 and 1987 on account of the change in accounting system to cash basis."

4. On the 12th March, 1933, the assessee's agent filed an application (Appendix C), paragraphs 3 and 4 of which run as under :—

"3. If as suggested above, the system of paying income tax on the credits in the Kasar Khata is brought into force again, I think that it would be necessary for me to pay tax on those amounts which were not taxed in the previous years Samwat 1983, 1984 and 1985, and I am willing to pay it. But I may not be taxed on those amounts all at once. The tax may be recovered from me in five or six instalments so that I may not have any difficulty in paying it. I think that in allowing this there is no loss to the Department either. This fact will be observed by anybody if he takes into consideration the change in the system of making assessments. Therefore, I have no objection if it is done as suggested above."

"At the same time, I was assessed ex-parte in Samwat year 1985. Therefore this year may not be taken into account."

5. On the 20th March, 1934, the Income tax Officer passed the following order :

"Shankar present with an application to the effect that the income of 1986 and 1987 Samwats has been assessed on mercantile system as per his opinion. I do not find any such statement in the orders of 1931-32 and 1932-33 assessment. His accounts are partly examined for assessment on cash basis system as in previous years. Assessee's agent is directed to show interest charged in their accounts but not shown for assessment on account of cash basis system in the accounts of 31 debtors from whom recoveries are shown in 1988 Samwat from 1983 to 1988 Samwats. He is also directed to produce accounts from 1983 to 1988 Samwat on 22-3-1934."

On the 27th of March, 1934, after the examination of the accounts was finished, the assessee's agent made the following statement (Appendix A) before the Income tax Officer :

"I wish as per my master's direction that the assessment be made on the income arrived at as per my system of accounting. I have returned the income according to Jamakharchi or Mahajani system of accounts. I show interest whenever the account of the debtor is settled or whenever interest is received in cash or whenever old document is renewed. From Samwat 1983 I used to show interest actually received and assessments on the income of 1983,

1984 and 1985 Samvats have been made on cash basis system. Jamakharchi interest of these years may be assessed by instalments in 2 or 3 years. I further state that the assessments of 1931-32 and 1932-33, that is, on the incomes of Samvat years 1986 and 1987 were made on Jamakharchi basis as per our accounting system and hence income of 1986 and 1987 Samvats was not assessed on cash basis system. Thus the income in 'Udhari interest' account should not be included in the assessment of 1933-34 and further whenever that interest is actually recovered. "Udhari Interest" of 1985 Samvat may also not be taxed whenever realised as that assessment was made *ex parte* ".

6. On the same date the Income-tax Officer passed the assessment order (Appendix B) holding that the income of the assessee in the previous year was Rs. 53,511-7-3 which includes an item of Rs. 23,043-7-3 as income on account of " interest charged in previous years (1983 to 1987) to debtors' accounts but not taxed under cash basis system in those years as interest now received in the account year (1988-89) either in cash or constructively.' It is the legality of the assessment of the aforesaid item of Rs. 23,000 odd that was unsuccessfully questioned by the assessee in his appeal to the Assistant Commissioner and which is the subject of the present reference.

7. The position taken by the assessee's learned Counsel before us was two-fold. In the first place, it was contended that as the proposal of the Income-tax Officer contained in his order-sheet dated 10-3-1934, was never accepted wholly by the assessee, he cannot be deemed in law to have " accepted in principle the conditions for the change in the system of accounting for the purposes of his income tax assessment for the assessment year 1933-34. It was next contended that even if the assessee accepted the proposal of the Income-tax Officer, such an acceptance gave no jurisdiction to the Officer concerned to assess the income on account of interest which had escaped assessment in the past five years preceding the account year. In our opinion both these contentions are sound.

8. The rule that a party cannot go behind his own admissions is founded on the principle that if he makes a qualified statement that statement cannot be used against him apart from that qualification. It has already been noticed before that the assessee in his application dated the 12th March, 1933 did not agree to the re-opening of accounts of the Samvat year 1985 and only agreed to being taxed on the supposed income from interest in the

other years provided that the tax was recovered in 5 or 6 instalments. In his last statement the assessee's agent further demurred to the re-opening of the accounts for the Samvat years 1986 and 1987 by alleging that the income in those years was assessed to tax on the mercantile system of accounting. In spite of these demurrers the Income-tax Officer proceeded to record in paragraph 4 of his final assessment order (Appendix B) the following—"As the assessee has applied for reverting to the method of accounting regularly employed by him in his books for purposes of assessment, I allow the change as per para 38(?) of the Income-tax Manual on the explicit understanding that the income, which has escaped assessment in previous years on the cash basis system, as proposed by the assessee and accepted for assessment purposes, will be assessed on receipt of the same whether in cash or constructively. I take the cash receipt and constructive receipt as recovery in the year in which the assessee will treat it as such according to his method of accounting regularly employed by him in his account books".

9. Under Sec. 13 of the Indian Income-tax Act income, profits and gains shall be computed for the purposes of Secs. 10, 11 and 12, in accordance with the method of accounting regularly employed by the assessee. It is conceded that in the assessment year 1933-34 the income, profits and gains of the assessee were only those which he made in the Samvat year ending with Diwali of 1988. It is also conceded that the method of accounting regularly employed by the assessee was the Mahajani or mercantile system throughout but that in view of this Court's decision in *Sir S. M. Chitnavis* v. *The Commissioner of Income Tax, Central Provinces* the income-tax authorities were careful enough to exclude, during the last five years, the items of interest which the assessee did not actually receive in cash in the year of accounting. What the assessee really desired in the first instance, in the assessment year in question was that the assessment on his income in the previous year, that is for Samvat 1988, should be on the basis of the mercantile system on which he had already been regularly maintaining his accounts and not on the cash basis which was adopted by the income tax authorities in view of this Court's ruling so far as the income from interest was concerned. Under these circumstances we fail to see the applicability of paragraph 38 (?) of the Income-tax Manual to the preset case.

10. As to the second contention it is enough to say that the only provision made by the legislature for levying tax on income escaping assessment in the past year is contained in Section 34 of

the Indian Income tax Act which runs as under:—"If for any reason income, profits or gains chargeable to income tax has escaped assessment in any year or has been assessed at too low a rate, the Income Tax Officer may, at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains, or, in the case of a company on the principal officer thereof, a notice under sub-sec. (2) of Sec. 22 and may proceed to assess or re-assess such income, profits, or gains, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section: Provided that the tax shall be charged at the rate at which it would have been charged had the income, profits or gains not escaped assessment or full assessment, as the case may be." The Income tax Officer in the present case had therefore no jurisdiction to re-open the past five years' accounts in the present proceedings and add Rs. 23,043-7-3 which might have escaped assessment in the past and treat it as income received in the account year Samvat 1988 for which the assessment was being made in the year 1933-34.

11. For the foregoing reasons we hold that the Income tax Officer was not justified in the first place, in holding that the assessee accepted in principle the conditions for the change in the system of accounting for the purpose of income tax assessment and secondly in assessing as income, profits or gains of the account year the amount of Rs. 23,043-7-3, the interest for the five years anterior to the year of account. The costs of this reference shall be paid by the Income tax authorities to the assessee. Pleader's fee Rs. 100.

Reference answered accordingly.

[IN THE MADRAS HIGH COURT.]

RAYALU AYYAR & CO.

v.

COMMISSIONER OF INCOME TAX, MADRAS.

SIR H. O. C. BEASLEY, C.J., KING, J., AND GENTLE, J.

March 31, 1936.

BUSINESS EXPENDITURE—PROFIT MADE BY SOME OF SEVERAL PARTNERS—SUIT BY EXCLUDED PARTNER FOR SHARE—PAYMENTS MADE TO EXCLUDED PARTNER UNDER DECREE AND LITIGATION EXPENSES, WHETHER ALLOWABLE DEDUCTION—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 10 (2) (ix).

In 1917 the assessees, the firm of S. & Sons, and 2 other persons entered into 4 contracts for the purchase of 720 bales of yarn from W. & Co., in 2 lots and they formed themselves into a partnership to deal with these 720 bales. The first lot of 360 bales were re-sold at a profit of Rs. 1,56,000, but, as the price of yarn fell, the partners got the contract with W. & Co., to purchase the second lot cancelled by paying to W. & Co., the profit earned in the first lot, though S. & Sons did not agree to this proposal. On the same date the assessees and the 2 other partners, excluding S. & Sons, entered into a contract with W. & Co., to purchase the second lot at a lower price and they made a profit of Rs. 72,000 by re-sale of this lot and they were assessed in 1921-22 on the profits made by this transaction. S. & Sons claimed a share in these profits and obtained a decree for Rs. 12,348. The assessees claimed that the sum paid to S. & Sons under the decree in 1932-33 and the litigation expenses which amounted to Rs. 2,074 should be deducted in computing their income for 1932-33, as business expenditure under Sec. 10 (2) (ix) of the Income Tax Act : Held, *on a reference by the Commissioner, that the payment to S. & Sons was a distribution of a share of the profits already earned and not an expenditure made to earn profits and could not be deducted under Sec. 10 (2) (ix).*

Case stated under Sec. 66 (3) of the Indian Income tax Act (XI of 1922) by the Commissioner of Income tax, Madras, in compliance with the order of the High Court dated 20th September 1935. (O. P. No. 156 of 1935).

CASE.

" In accordance with the High Court's order quoted above, I have the honour to refer the following case for the decision of the Hon'ble the Judges of the High Court under Sec. 66 (3) of the Indian Income tax Act, XI of 1922 (hereinafter referred to as the Act).

2. The petitioners constitute an unregistered firm assessed by the Income tax Officer, Madura (South) Circle. Prior to the year *Dundubi* (1922-23), they carried on business in yarn, lace and piece-goods in various places in British India with Madura as their principal place of business; they also carried on business in money-lending. In 1922-23 the business in yarn etc., was stopped and its outstandings and liabilities were amalgamated with the money-lending business. From the year 1924-25 onwards the firm sustained losses each year and consequently the firm as such was not assessed to tax but the share of the loss of each partner as determined by the Income tax Officer was allowed as a set-off in the

individual assessment of the partners. In the account year 1932-33 to which this " reference relates the only business carried on by the petitioner firm was money-lending."

3. For the tax year 1933-34 previous year Tamil year Angirasa, corresponding to 13th April 1932 to 12th April 1933—the Income tax Officer determined the firm's loss from business to be Rs. 1,487. In computing the loss he disallowed among other items Rs. 12,438 being the amount paid to a firm of yarn merchants named K. M. Subbier and Sons in pursuance of the decree of the Madras High Court in O.S.A. Nos. 65-28 and 90-29 (C.S. No. 187-21), and Rs. 2,074 being the expenses incurred by the petitioner firm in connection with the above litigation. This reference arises out of the disallowance of the above two sums. The facts relating to these are as follows:—

In December 1917 the petitioner firm and 3 other yarn merchants, among these the firm of K.M. Subbier and Sons mentioned above, entered into 4 separate and independent contracts with Messrs. Walker & Co., Madras, to purchase two lots of 90 bales each or 720 bales in all of 60 s. Peacock Turkey Red Yarn. The price of the first lot of 360 bales was fixed at Rs. 23-8-0 per bundle (80 bundles make one bale) that of the second lot being left over to be settled later. In July 1918, the petitioner firm and the 3 other merchants mentioned above entered into a partnership contract to deal with these 720 bales: the petitioner firm was to manage the business, they having 2 out of 5 shares and each of the three others one out of 5. In October 1918, the price of the second lot of 360 bales was fixed at Rupees 26-13-0 a bundle. By the end of May 1919, the first lot of 360 bales had been sold at a profit of Rs. 1,56,000. After the declaration of the Armistice in November 1918, the price of yarn fell and the petitioner firm and another partner of this venture, other than K.M. Subbier and Sons, proposed to the other partners that they should get the contracts for the second lot cancelled by giving up to Messrs. Walker & Co. as damages the profit they had made on the first lot of 360 bales. K.M. Subbier & Sons, did not agree to this proposal, for according to them, even though the partnership was not likely to make much profit in the 2nd lot, it was certain not to suffer loss. But the proposal was carried by the other partners. Messrs. Walker & Co. accepted this proposal. The profit of Rs. 1,56,000 was accordingly paid to them by the 20th June 1919, and the contracts for the second lot of 360 bales were cancelled by them on this date. On the very same day, the peti-

tioner firm and the other two partners, other than K. M. Subbier and Sons entered into a fresh contract with Messrs. Walker & Co., to repurchase the second lot of 360 bales at Rs. 21-1-0 a bundle, when the market rate was Rs. 24-12-0 per bundle. From this contract K. M. Subbier & Sons were excluded. The profit made on this contract as found by the Court was Rs. 72,000. K.M. Subbier and sons filed a suit (C. S. 187-21) against the petitioner firm and the two other partners in the High Court of Madras, and alleged that they were entitled to a share of the profits made on the sale of the second lot under the re-purchase contract. The Court upheld the plaintiffs' contentions and passed a decree in their favour. In accordance with the decree, the petitioner firm had to pay K. M. Subbier and Sons, Rs. 12,348 in the year of account being their share of the profits withheld from Subbier and Sons. The expenses incurred by the petitioner firm in connection with the litigation amounted to Rs. 2,074. In the assessment made upon the petitioner firm for 1921-22 a sum of Rs. 48,999 was included as their profit in a joint venture in yarn entered into by them with Messrs. Walker & Co., and two other firms, which apparently refers to the contract mentioned above. On these facts the petitioner firm claimed that the two sums in question were bad debts and should be taken into account in determining their loss for the year now in question. The Income-tax Officer held that the sum of Rs. 12,348 was not a bad debt but a payment of a share of profit to which K. M. Subbier and Sons were entitled to according to the decree of the Court and which the petitioner firm had withheld from them and that it was therefore not allowable. The litigation expenditure also was disallowed on the same ground.

4. The petitioner firm appealed to the Assistant Commissioner and contended that even though the sum in question was not a debt, strictly speaking, still as a payment out of profits once taxed it was a legitimate deduction and that their case having been that K. M. Subbier and Sons were not partners entitled to participate in the profits of the joint venture the payment of the amount was in the nature of damages. The Assistant Commissioner held that inasmuch as the yarn business was discontinued several years ago, and the sum in question was paid in the course of the liquidation of the discontinued business, it must be regarded as being of a capital nature. He confirmed also the disallowance of the litigation expenditure on the same ground. An extract from his order is filed marked Ex. A.

5. The petitioner firm filed an application under Sec. 66 (2) of the Act and requested me to state a case and refer a question alleged to be a question of law arising out of the Assistant Commissioner's order. I declined to state a case on the ground that no question of law arose. An extract from my order is filed, marked Ex. B.

6. The petitioner firm then moved the High Court under Sec. 66 (3) of the Act to direct me to refer two questions marked (i) and (ii) in the petition to the High Court and the High Court has by its order dated 20th September 1935 directed me to refer the following question:—"Whether the sums of Rs. 12,348 and Rs. 2,074 should not, in the circumstances of the case, be deemed to form an item of expenditure allowable under the Indian Income tax Act, XI of 1922".

7. The petitioners' contention is that they are carrying on a business and that the sums in question are expenses allowable in computing the profits of that business under Sec. 10 of the Act. The statement of facts given in paragraph 3 above will show that during the relevant account year, *viz.*, 1932-33, the petitioner firm was carrying on the business of money-lending only and that the amount claimed as expenditure is the share of profits of the joint yarn business done in 1921-22 to which K.M. Subbier and Sons were found to be entitled by the Court but which the petitioner firm had wrongly withheld from them. The expenditure allowable in computing the profits or gains of a business under Sec. 10 of the Act is given in sub-Sec. (2) Clause (i) to (ix) of that section. The amounts claimed by the petitioner firm do not come under Clauses (i) to (viiia.) There remains clause (ix) which refers to expenses other than those referred in Clauses (i) to (viiia). In order to maintain a claim under this clause two conditions have to be satisfied, *viz.*, (a) the expenditure should not be "in the nature of capital expenditure", and (b) it should have been "incurred solely for the purpose of earning such profits and gains".

As already stated, the amount claimed is what the petitioners had to pay on account of the share of the profits of the year 1921-22 wrongly withheld by them. It is only an allocation of the profit already earned in 1921-22. The transaction amounts to the repayment of a debt. The expenditure is therefore one "in the nature of capital expenditure".

Secondly, the payment of these sums did not arise out of any transactions carried on with a view to earn any profits in the sense that they were really incidental to the trade itself. They arose

out of a fraud committed by the petitioner firm in 1921-22 in allocating the profits earned in that year. That was not an act incidental to the carrying on of any business—yarn trade or money-lending—carried on by the petitioner firm. Hence the amount paid cannot be said to be expenditure incurred solely for the purpose of earning any profits or gains within the meaning of Sec. 10 (2) (ix). The claim is analogous to the one that was the subject matter of the decision of this Court in *Ramaswamy Chettiar* v. *Commissioner of Income Tax, Madras*, (4 I.T.C. 438), and followed in *Gadodia* v. *Commissioner of Income Tax, Punjab*, (7 I.T.C. 393).

For the reasons stated above I am of the opinion that the conditions required by clause (ix) of sub-Sec. (2) of Sec. 10 of the Act have not been satisfied and that therefore the expenditure claimed is not allowable under the Act. The question should accordingly be answered in the negative."

M. Subbaraya Aiyar for the Assessees.

M. Patanjali Sastri for the Crown.

JUDGMENT.

THE CHIEF JUSTICE :—The question propounded is :—"Whether the sums of Rs. 12,348 and Rs. 2,074 should not, in the circumstances of the case, be deemed to form an item of expenditure allowable under the Indian Income tax Act, XI of 1922".

The amounts claimed it is contended are allowable under Sec. 10 (2) (ix) of the Act as being an expenditure incurred solely for the purpose of earning such profits or gains.

The facts are that in December 1917 the assessee firm and three other yarn merchants, among these the firm of K. M. Subbier and Sons, entered into four separate and independent contracts with Messrs. Walker and Co., Madras, to purchase two lots of 90 bales each or 720 bales in all of Peacock Turkey Red yarn. The price of the first lot of 360 bales was fixed at Rs. 23-8-0 per bundle, that of the second lot being left over to be settled later. In July 1911 the assessee firm and the three other merchants before mentioned entered into a partnership contract to deal with these 720 bales: the assessee firm was to manage the business, they having two out of five shares and each of the three others one out of five. In October 1918 the price of the second lot of 360 bales was fixed at Rs. 26-13-0 a bundle. By the end of May 1919 the first lot of 360 bales had been sold at a profit of Rs. 1,56,000. After the declaration of the Armistice in November 1918, the price of yarn fell and the assessee firm and another partner of this

venture other than K. M. Subbier and Sons proposed to the other partners that they should get the contracts for the second lot cancelled by giving up to Messrs. Walker and Co., as damages the profit they had made on the first lot of 360 bales. K. M. Subbier and Sons did not agree to this proposal, for according to them even though the partnership was not likely to make much profit in the second lot, it was certain not to suffer loss. But the proposal was carried by the other partners. Messrs. Walker and Co., accepted this proposal. The profit of Rs. 1,56,000 was accordingly paid to them by the 20th June 1919 and the contracts for the second lot of 360 bales were cancelled by them on that date. On the same day, the assessee firm and the other two partners, other than K. M. Subbier and Sons, entered into a fresh contract with Messrs. Walker and Co., to repurchase the second lot of 360 bales at Rs. 21-8-0 a bundle when the market rate was Rs. 24-12-0 per bundle. As before stated K. M. Subbier and Sons were excluded from this contract. The profit made on this contract as found by the High Court was Rs. 72,000. K.M. Subbier and Sons filed a suit against the assessee firm and the two partners in the High Court and claimed that they were entitled to a share of the profits made on the sale of the second lot under the repurchase contract. WALLER, J., upheld the plaintiffs' contentions and passed a decree in their favour, and this decree was confirmed on appeal by myself and CORNISH, J. In accordance with the decree the assessee firm had to pay K. M. Subbier and Sons Rs. 12,348 in the year of account being their share of the profits which had been withheld from them ; the expenses incurred by the assessee firm in connection with the litigation amounted to Rs. 2,074. In the assessment made upon the assessee firm for 1921-22 a sum of Rs. 48,999 was included as their profit in the joint venture in yarn entered into by them with Messrs. Walker and Co.; and two other firms.

The position is this, therefore that the assessees now claim that the sum paid to K. M. Subbier and Sons, namely Rs. 12,348 and the litigation expenses incurred in the suit, namely Rs. 2,074 should be deducted from the amount returned as the profits of the firm for the year 1921-22 because that payment, it is contended was made to Subbier and Sons, solely for the purpose of earning the profits and gains of the partnership. The short answer to the assessee's contention is that for 1921-22 the profits of the transaction were returned as Rs. 48,999 and the Rs. 12,348 paid to Subbier and Sons was the latter's share of those profits. This payment was a distribution of profits already earned and nothing else,

and it cannot, in my opinion with any show of reason, be contended that it was an expenditure incurred solely or even in part for the purpose of earning such profits. The amount itself was a part of the profits. How could the payment to Subbier and Sons help to earn the profits already earned or increase them? This was nothing more, as I have already stated, than a distribution of the profits of the partnership to one of its co-sharers. If the contention now advanced by the assessee firm were correct, it would mean that all of the profits earned when distributed could escape liability to assessment from income tax, because a payment to any one of the partners could, for the reasons advanced be excluded as an expenditure incurred solely for the purpose of earning the profits of the partnership. In my view, the contention cannot succeed and the answer to the question propounded must be in the negative. Costs of the Commissioner of Income tax Rs. 250.

KING, J.—I agree.

GENTLE, J.—I agree.

[IN THE NAGPUR JUDICIAL COMMISSIONER'S COURT.]

CENTRAL PROVINCES MANGANESE ORE CO. LTD.

v.

COMMISSIONER OF INCOME TAX, C. P. & U. P.

SUBHEDAR and GRUER, A. J. Cs.

December 16, 1935.

DEPRECIATION OF MACHINERY—SUSPENSION OF WORK—MACHINERY REMAINING IDLE DURING ACCOUNT YEAR—PROFITS DERIVED THROUGH USE OF MACHINERY IN PREVIOUS YEARS—DEPRECIATION, WHETHER ALLOWABLE—'USED FOR THE PURPOSES OF THE BUSINESS,' MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), Sec. 10 (2) (ix).

The assessees carried on the business of mining and selling manganese ore. Owing to depression in trade mining operations in some of the mines were suspended in 1931 and the machinery and plant attached to them remained idle. In the assessment for the account year 1932, the income tax authorities disallowed depreciation allowance on that part of the assessee's machinery which remained idle in the said year. The assessee's machinery inasmuch as the income sought to be assessed was derived partly

from the sale of ore which had been won in previous years through the use of the machinery in question they were entitled to depreciation allowance in respect of this part of the machinery also :

Held, *on a reference by the Commissioner, that the expression 'used for the purposes of the business' in Sec. 10 (1) (iv) means 'used for the purposes of the business during the account year' and not merely that the machinery must not have been used for other purposes, and depreciation allowance could not be allowed merely because the stocks sold during the account year were the result of the use of the machinery in previous years.*

Cases referred to :

BHIKHAJI VENKATESH *v.* COMMISSIONER OF INCOME TAX, C.P. and U.P. [1936] (1937 I.T.R. 626; 8 I.T.C. 410).

N. D. RADHAKISHEN & SONS *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1929] (3 I.T.C. 73).

SRI GOPALJI CO. *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1931] (5 I.T.C. 267; A.I.R. 1931 Lah. 376; 32 P.L.R. 335; 1931 Comp. Cas. 299).

Case stated under Sec. 66 (2) of the Indian Income tax Act (XI of 1922) by the Commissioner of Income-tax, Central and United Provinces (Miscellaneous Judicial Case No. 49 of 1934).

CASE.

" The assessee is the Central Provinces Manganese Ore Company Limited, with its headquarters at Nagpur.

The company is the lessee of a number of mines in the Central Provinces. The business carried on is the mining and sale of manganese ore. The account year of the company is the calendar year and in the year 1932, the mining operation in some of the mines having suspended, the machinery and plant intended for the purpose remained idle.

For the assessment year 1933-1934 the Company returned a profit of Rs. 5,36,165 subject to an allowance on account of depreciation. This allowance worked out to Rs. 1,89,541 but the Income tax Officer, Nagpur, who was the proper assessing Officer in this case, allowed Rs. 1,79,741 only, having disallowed Rs. 9,800 representing depreciation on that part of the company's machinery which, in consequence of the suspension of the operations in the mines referred to above, remained idle during the account year. It was urged on behalf of the assessee that, as the income of the account year was derived partly from the sale of the ore which, in previous years, had been won through the use of the machinery,

the Company was entitled to it despite the fact, not disputed, that in the account year the machinery was dormant. For reasons given in his order the Income tax Officer over-ruled this contention and made an assessment in the amount of Rs. 3,56,424. It is admitted that the profits assessed included profits from the sale of stocks which had been won through the instrumentality of the machinery in years anterior to the account year. Relevant extract from the assessment order will be found in Appendix A.

The assessee filed an appeal but was unsuccessful, the Assistant Commissioner confirming the Income Tax Officer's decision. A copy of his order is in appendix B.

The assessee has now presented a petition (Appendix C) praying alternatively that I should either allow the depreciation disallowed by the Officers below or refer the following questions of law for the decision of the Hon'ble the High Court :—

(1) "Whether the words 'used for the purposes of the business' in Sec. 10 (2) (iv) of the Indian Income tax Act, 1922, mean 'used for such purposes during the account year' or as claimed by your petitioners that the machinery must not have been used for other purposes.

(2) "Whether in view of your petitioner's business being the sale as well as the mining of manganese ore and in view of the fact that part of the taxed profits arose from the sale of stocks of ore mined previously to the account year but in the winning of which the machinery was instrumental, the same machinery should not be considered as being used for the purpose of 'business' and the depreciation on it allowed as a deduction under Sec. (10) (2) (vi) in the account year."

Being at one with the finding and decision of the Income tax Officer and the Assistant Commissioner, I am unable to allow the company the desired relief. From a strictly artistic point of view it may be possible to improve the question (1) as framed by the assessee but as it accurately reflects the case in point and also, in conjunction with the second question, the extent to which the facts are admitted, I refer it in the form in which the assessee has propounded it. It is, however, submitted that question No. (2) is only an argument in favour of the assessee's contention and does not raise any substantive point of law. I am therefore, unable to refer it in an altered form as the decision of the Honourable Court on the first question, if favourable to the assessee, will enable me to give all the relief desired.

The decision of the question turns solely on the interpretation of the words 'used for the purposes of the business' occurring in Sec. 10 (2) (iv). It is common ground that these words govern sub-clauses (v) and (vi) also. The argument, founded on the identity of the risk involved irrespective of whether the machinery was active or dormant begs the whole question. It assumes that premium paid in respect of insurance against risk of damage, etc., is an admissible charge under sub-clause (iv) of clause (2) of Sec. 10, no matter whether the machinery has been active or dormant in the account year. There is no basis for this assumption, nor is there ambiguity about the language used. The words used are 'used for the purposes of the business' and the question is purely one of when used, or one of time, *i.e.*, whether used at any time or used only in the account year. It is respectfully submitted that in interpreting a statute no extraneous arguments can be imported if a consistent meaning can be found within the four corners of the statute itself. Sec. 10 does not specify any period of time. But that section is controlled by Sec. 3 of the Indian Income-tax Act and this section has reference to 'previous year'. The words 'previous year' are a definite expression under the Act and include an account year such as that of the assessee. The words in question occurring in clause (iv) of Sub-sec. 2 of Sec. 10 must, it is respectfully submitted, therefore, be construed as referring to the account year. Indeed where an allowance is to be made for a longer period than that covered by an account year or where the allowance is such that it cannot be ascertained until a period posterior to an account year, the Legislature has definitely made provision in sub-clauses (vi) and (vii) of this very section. There is, therefore, no ambiguity either in the language used or as regards what, for whatever reason, the Legislature intended to enact. The words in question have reference to the account year and if the machinery remained idle in that year, as it admittedly did in in this case, no depreciation was admissible. In this view I am fortified by the ruling of the Lahore High Court in *N. D. Rudhakishen & Sons* v. *The Commissioner of Income-tax, Punjab*, and in my opinion, the first part of the question should be answered in the affirmative and the second in the negative.

D. N. Choudhury, for the Crown.

JUDGMENT.

This is a reference under Sec. 66 of the Income-tax Act. The non-applicant assessee is the Central Provinces Manganese Ore

Company Ltd., Nagpur, through its agent and General Manager, Mr. Bartlett, and he objects to the disallowance of a sum of Rs. 9,800 as depreciation on the part of the Company's machinery, which remained idle during the account year in question. Owing to depressed trade, part of the works was closed down after 1931, and the accumulated stock was sold in subsequent years. The Company's contention is that, as the income during the account year was obtained out of the sale of the ore, which had been won through the use of the machinery working in the previous year, therefore depreciation should be allowed for that machinery even in the year in which it was not being used.

2. The questions referred for decision are as follows :—

"Whether the words "used for the purposes of the business" in Sec. 10 (2) (iv) of the Indian Income-tax Act, 1922, mean "used for such purposes during the account year" or as claimed by your petitioners that the machinery must not have been used for other purposes.

"(2) Whether in view of your petitioners' 'business' being the sale as well as the mining of manganese ore and in view of the fact that part of the taxed profits arose from sale of stocks of ore mined previously to the account year but in the winning of which the machinery was instrumental, this same machinery should not be considered as being used for the purpose of "business" and the depreciation on it allowed as a deduction under Sec. 10 (2) (vi) in the account year".

2. As pointed out by the Commissioner of Income-tax, in his opinion, the second question is not really a distinct one, and the only point in the case is the interpretation to be put on the phrase "used for the purposes of the business" which occurs in Sec. 10 (2) (iv) of the Income-tax Act.. This phrase has undoubtedly to be read into the subsequent sub-Sec. (vi) under which depreciation can be claimed. The assessee's contention is that the phrase does not mean "actually used for such purposes" during the account year, but that the machinery was "not used for other purposes". It seems to us a straining of the language to turn a positive description into a negative one, and that interpretation would allow an assessee to claim depreciation for machinery, which although suitable for the business, had never been brought into use at all; and also to go on claiming depreciation for years together without using the machinery, provided only that the accumulated stocks were being gradually disposed of. The assessee would distinguish the case of *N. D. Radhakishen & Sons* v. *Commissioner*

of Income Tax, Punjab, on the ground that the facts are different. No doubt the case concerned a motor car and not factory machinery, but the general principle discussed and decided was precisely the same, and the decision is adverse to the assessee's present contention. The answer in that case was that the words "used for the purposes of the business" mean "used for such purposes during the accounting year." No doubt machinery may depreciate from disuse as well as from use, but, as noted by the Judges in that case, the allowance is granted not for depreciation as such, but for depreciation as a consequence of the earning of income or while employed in the earning of income. Section 10 was similarly found inapplicable in *Sri Gopalji* v. *The Commissioner of Income-tax, Punjab*. There is also a case of this Court *Bhikaji Venkatesh* v. *The Commissioner of Income-tax, Central and United Provinces*, which goes against the assessee's contention, and he has not been able to produce any other case in his favour.

3. No doubt on the above view, as depreciation is allowed only for a number of years, the effect of the machinery lying idle might be that full allowance of depreciation is not finally recovered. The result might, however, be got over by using the machinery for a short time each year. The plain significance of the rule must be adhered to, and we must decide in favour of the Income-tax Commissioner. We therefore, answer the first part of the question (1) in the affirmative, and the second part in the negative; and state that the second question does not require any separate answer. Costs of this application will have to be borne by the non-applicant assessee. Pleader's fees will be Rs. 50.

Reference answered accordingly.

[IN THE HIGH COURT OF ALLAHABAD.]

SETH KANHAIYALAL

v.

COMMISSIONER OF INCOME TAX, C. P. & U. P.

COLLISTER and BAJPAI, JJ.

March 25, 1936.

FIRM—INTEREST PAID TO PARTNERS TREATED AS PROFITS OF FIRM—FIRM NOT ASSESSED OWING TO NET LOSS—INTEREST RECEIVED BY PARTNERS, WHETHER EXEMPT FROM TAX—ASSESSMENT—JURISDICTION TO ASSESS—OBJECTION AS TO PLACE

OF ASSESSMENT, WHETHER CAN BE TAKEN IN APPEAL—REFERENCE, COMPETENCY OF—FINALITY OF COMMISSIONER'S DECISION—WRONG DESCRIPTION OF OFFICER, WHETHER AFFECTS HIS JURISDICTION—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 14 (2) (b), 64 (3), 66.

Under Sec. 30 of the Indian Income Tax Act an assessee has a right of appeal from an assessment made by an Income Tax Officer only as regards his liability to be assessed under the Act or as regards the amount or rate at which he has been assessed. He cannot raise an objection to the place of assessment for the first time in appeal and even if he raises such an objection in appeal, the question cannot properly be said to arise out of the appellate order of the Assistant Commissioner and there can be no reference to the High Court on the question.

Under Sec. 64 (3) of the Indian Income Tax Act, where a question arises as to the place of assessment it has to be decided by the Commissioner or the Central Board of Revenue and their decision is final. There is no right of appeal and no power in the High Court to interfere with it, nor do the provisions of Sec. 66 which give the assessee a right to require the Commissioner to state a case to the High Court apply to a decision made under Section 64.

The exemption conferred by Sec. 14 (2) (b) on a partner's share of the profits of a firm which has been assessed applies only if the firm had made profits and those profits had been assessed to income-tax. *Where the entire income of a firm without deducting interest which it had paid to the various partners was taken into calculation in computing its income, but the firm was not assessed to income-tax because of certain losses which had absorbed the entire income and left the firms with a net loss instead of profit:* Held, *that the sums received by the partners as interest were not exempt from income-tax under Section 14 (2) (b), as the profits of the firm had not been assessed to tax.*

The mere fact that an Income Tax Officer had incorrectly designated himself will not divest him of the jurisdiction which he possesses in fact.

Case referred to:

DINANATH HEMRAJ *v.* COMMISSIONER OF INCOME TAX, U. P. [1927] (2 I.T.C. 304; I.L.R. 49 All. 616; 100 I.C. 756; A.I.R 1927 All. 299).

Case stated by the Commissioner of Income Tax, C. P. and U. P., under Section 66 (2) of the Indian Income Tax Act, XI of 1922. [Civ. Mis. Case No. 348 of 1935].

JUDGMENT.

COLLISTER, J.—This is a reference under Sec. 66 (2) of the Indian Income-tax Act. The assessee is a joint Hindu family living in Khurja in the Bulandshahr district, whose head and representative is one Seth Kanhaiya Lal. The assessment-year is 1933-34, the assessee is a partner to the extent of a one-third share in the firm of Messrs. Sadhoram Tularam at Calcutta. The Income-tax Officer of Calcutta found that this firm had paid Rs. 3,33,279 to its partners and he treated this as income of the firm; that is to say, no allowance was granted in respect to this sum. According to his calculations there was a profit of Rs. 1,33,039, but against this he set off a certain sum on account of depreciation and took into account certain other matters with which we are not concerned and ultimately he worked out a net loss to the firm of Rs. 5,434. He thereafter reported to the Income-tax Officer of Meerut that the assessee's one-third share amounted to Rs. 50,820, which sum was arrived at in the following way.

	Rs.
Net loss of the Calcutta firm	5,434
Interest to partners	3,33,278
Gross loss of the Calcutta firm	3,38,713
One-third share of the assessee in the gross loss under the head of interest	1,11,094
Interest actually paid to the assessee	1,61,913
Net share of the assessee	50,820

The assessee's income from property at Khurja amounted to Rs. 360 and the Income-tax Officer added this amount to the sum of Rs. 50,820 and levied income tax upon the assessee in the amount of Rs. 51,180. He over-ruled the assessee's objection that the assessee's share in the Calcutta firm amounting to Rs. 50,820 was not liable to assessment. The assessee applied to the Assistant Commissioner of Income tax and in his grounds of appeal he also raised a plea of jurisdiction; but the appeal was dismissed. Thereafter the assessee applied to the Income-tax Commissioner for a reference to be made to this Court under Section 66 (2) of the Act. The Income-tax Commissioner has accordingly stated a case and has referred three questions of law to this Court. It may be mentioned here that the Income-tax Officer had omitted to take into account the assessee's one-third share in the net loss of the Calcutta firm, *i.e.*, in the sum of Rs. 5,434, 1/3rd of that amount being Rs. 1,811. He has now corrected the error and finds that the assessee's share in the firm works out at Rs. 49,000.

The three questions of law which have been referred to this Court are as follows :—(a) whether the Income-tax Officer, Meerut, had jurisdiction to make the assessment in question ; (b) whether the amount of Rs. 51,180 had been correctly treated as the assessee's share in the Calcutta firm for the assessment year in dispute ; (c) whether in view of the provisions of Sec. 14 (2) (b) the amount was exempt from income tax.

Question.—(a) This plea has been argued before me on two grounds. The first ground is a pure technicality. In his assessment order the Income-tax Officer signed himself as the Income tax Officer, Meerut, and it is contended that this was a wrong designation.

A notification was issued under Sec. 5 (4) of the Income-tax Act on the 4th May 1934 under which an Additional Income-tax Officer was appinted for the Meerut circle and was to have jurisdiction in the Meerut City and in the district of Bulandshahr.

The appellate order of the Assistant Commissioner of Income tax dated 16th November 1924 shows that it was conceded before him by the assessee that there was an Additional Income-tax Officer of Meerut at the date of the assessment order, *i.e.*, on the 28th June 1934, and that it was that official who made the said assessment order. Obviously the mere fact that the official in question incorrectly or inadvertently designated himself as the Income-tax Officer, Meerut, instead of the Additional Income-tax Officer of Meerut City and Bulandshahr district cannot divest him of his jurisdiction.

The second ground is that since the assessee was doing business at Calcutta as a partner in the firm of Sadhoram Tularam, the assessment should have been made at Calcutta and not at Khurja.

Clause (1) of Sec. 64 of the Act reads as follows :—" Where an assessee carries on business at any place, he shall be assessed by the Income-tax Officer of the area in which that place is situate or where the business is carried on in more places than one, by the Income-tax Officer of the area in which his principal place of business is situate." Clause (2) reads :—" In all other cases an assessee shall be assessed by the Income-tax Officer of the area in which he resides."

In the view which I take, however, upon the question of jurisdiction it will not be necessary to consider whether the assessee was " carrying on business " at Calcutta within the meaning of clause (1) of Sec. 64. Claue (3) of that section reads as follows :—" Where any question arises under this section as to the

place of assessment, such question shall be determined by the Commissioner or where the question is between places in more provinces than one, by the Commissioners concerned, or if they are not in agreement, by the Central Board of Revenue; provided that before any such question is determined the assessee shall have had an opportunity of representing his views."

The provisions of Sec. 64 are concerned with the assessment which an Income-tax Officer makes and clause (3) appears to me to contemplate a question of jurisdiction arising at the time of such assessment and not at any future stage. If the Income-tax Officer has any doubt as regards his jurisdiction or if he is moved by the assessee the question of jurisdiction will "arise" and it will then be his duty to refer the matter to the Commissioner in order that the latter may proceed in the manner laid down by clause (3). In *Messrs. Dina Nath Hem Raj* v. *Commissioner of Income Tax, United Provinces* (2 I.T.C. 304) the Income-tax Officer of Cawnpore had assessed a certain firm to Income-tax at Cawnpore in spite of the firm's objection that the assessment ought to be made at Calcutta. The firm appealed but its appeal was dismissed. An application was then made to the Commissioner of Income-tax to state a case under Sec. 66 of the Act, but the application was refused. Thereafter an application was made to this court for a rule directing the Commissioner to state a case, and this was allowed. It was held by a Bench of this Court that if the question as to the place of assessment had been decided in accordance with Sec. 64 (3) of the Act, the High Court could not have interfered, but as in the circumstances of that case there had been a total failure of the Income-tax authorities to apply the provisions of Sec. 64 (3) and an illegal assumption of authority by the Income-tax Officer of Cawnpore, the assessee had a right to have a case stated. At page 313 the following passage occurs in the judgment: "Where such a question as we have indicated arises as to the principal place of business and such question has been determined by the Commissioner or where the question is between places in more provinces than one, by the Commissioners concerned or by the Board of Inland Revenue, such decision is final. There is no right of appeal and no power in the High Court to interfere with it, nor do the provisions of Sec. 66, which give the assessee a right to require the Commissioner to refer to the High Court any question of law, or in the event of his refusal to apply to the High Court for a statement of the case, apply to a decision made under Sec. 64. No doubt under Sec. 66 (1) the Commissioner may on his own motion

refer a case to the High Court on any question of law arising in the determination of the question under Sec. 64 but this seems to be the only way in which the determination of such question can be brought before the High Court".

It will be observed that in that case an objection as regards the place of assessment was made at the earliest moment, *i.e.*, at the time of the assessment proceedings. In the present case, however, no question of jurisdiction arose at the time of assessment inasmuch as the assessee did not object to being assessed at Khurja and the Income-tax Officer himself had apparently no doubt in his own mind as regards his jurisdiction and he was therefore under no necessity to refer the matter to the Commissioner of Income-tax. In my opinion the provisions of clause (3) of Sec. 64 were not intended to apply to any stage after the making of the assessment order.

If the assessee had no right to object in the matter of jurisdiction after the assessment order had been made, it has to be considered whether this is a "question of law arising out of" the appellate order within the meaning of clause (2) of Sec. 66. It cannot be denied that the question of jurisdiction was raised in appeal before the Assistant Commissioner inasmuch as one of the grounds of appeal was that the Additional Income-tax Officer had no jurisdiction to make the assessment: and thereafter the assessee moved the Commissioner to state a case for the decision of the High Court on the ground that this point—among others—had been decided against him by the Assistant Commissioner. There is, of course, nothing to prevent an assessee from putting any plea he may choose into his memorandum of appeal and in that way it can be said that a decision of any such point will create a "question arising out of the appeal"; but what is to be seen is whether the question is one that properly arises out of the appeal. In other words, was the assessee competent to raise this plea before the Assistant Commissioner? Sec. 30 of the Act provides that "any assessee objecting to the amount or rate at which he is assessed under Sec. 23 or Sec. 27 or denying his liability to be assessed under this Act ... may appeal to the Assistant Commissioner against the assessment ...". I have omitted such portion of the section as is irrelevant. From the language of the section it is clear that an assessee has a right to appeal only as regards his liability to be assessed under the Act or as regards the amount or rate at which he has been assessed; he is not competent to object in appeal as regards the place of jurisdiction. It

appears to be the policy of the Act that if there is to be any question of the Income tax Officer's jurisdiction, it must be done at the time of the assessment proceedings and not at any later stage. It is argued before us that in an ordinary civil litigation a question of jurisdiction can be raised at any time and that by analogy an assessee under the Income-tax Act should have the same right. But Sec. 21 of the Civil Procedure Code enacts that: "No objection as to the place of suing shall be allowed by any appellate or revisional Court unless such objection was taken in the court of first instance at the earliest possible opportunity and, in all cases where issues are settled, at or before such settlement and unless there has been a consequent failure of justice." Thus the analogy does not help the assessee. In my opinion the assessee was not competent to ask the Commissioner of Income-tax to state a case on the question of jurisdiction to the High Court.

It is argued that the Income-tax Commissioner could have stated a case on the question of jurisdiction *suo motu* under Sec. 66 (1) at any stage, and we are asked to treat this reference which has been made under Sec. 66 (2) as though it were a reference under Sec. 66 (1). If we acceded to the request it would follow that the limitation in clause (2) would have no meaning. In any case, it is difficult to see how the High Court of this province could decide a question of jurisdiction affecting the income-tax authorities of Calcutta unless the two Commissioners had agreed to abide by the decision of this court. I can quite understand that *at the time of assessment*, if the Income-tax Commissioner of a particular province were moved by an Income-tax Officer under him on the question of jurisdiction in respect of two or more districts in the province and if he were himself in doubt, he could state a case under Sec. 66 (1) to the High Court of his province, but I am inclined to doubt whether it would be in accordance with the spirit and scheme of the Act that even this should be done after the assessment has been made. Be this as it may, I am clearly of opinion that the reference in the present case was incompetent under Sec. 66 (2).

It is contended by learned counsel for the department that in any case, if there was a defect in jurisdiction it was cured by clause (4) of Sec. 64. That clause reads as follows: "Notwithstanding anything contained in this section, every Income-tax Officer shall have all the powers conferred by or under this Act on an Income-tax Officer in respect of any income, profits or gains accruing, or arising or received within the area for which he is appointed."

The interest paid to the assessee was certainly not income which "arose" at Khurja and I do not think that it "accrued" at Khurja. It is not contended before us on behalf of the Department that it has ever been remitted from Calcutta to Khurja and therefore there is no need to consider whether it was "received" at Khurja within the meaning of clause (4).

Questions (b) and (c). The interest which became payable to the partners was income of the firm and was rightly treated as such by the Income-tax Officer at Calcutta. No allowance was made under Sec. 10 (2) (iii) and it is conceded by learned counsel for the assessee that no such allowance could be made. As remarked by the Income-tax Commissioner: "What purports to be interest paid to the assessee was, in fact, allocation of the profits of the Calcutta firm distributed in the form of interest to the assessee, and as, in consequence of losses which exceeded its profits, the firm was not assessed to any income-tax, the amount is not covered by the exemption conferred by Sec. 14 (2) (b)". Learned counsel for the assessee contends however that since this money was assessed as income from business of the firm, it cannot be assessed a second time in the hands of a partner and can no longer be regarded as income taxable under the Act. In other words, he pleads that since it has been treated as income of the firm, it cannot on division, become income of the partners who compose such firm. I am unable to accept the view. The sum of Rs. 51,180 is profits accruing personally to the assessee from money invested by the assessee in the firm in his capacity as an individual partner. As the assessee was not doing business at Calcutta in his individual capacity, the interest which has accrued to him upon his investment is income "from other sources" as contemplated by Sec. 6 (vi) of the Act. Sec. 16 (1) provides that "in computing the total income of an assessee sums exempted under......sub-section (2) of Sec. 14......shall be included". And Sec. 14 (2) (b) provides that the tax shall not be payable by an assessee in respect of "such an amount of the profits or gains of any firm which have been assessed to income-tax as is proportionate to his share in the firm at the time of assessment". Thus it is clear that a partner's share in the profits of a firm is income and must be computed as such. If the profits of the firm have been assessed to income-tax the partner's proportionate share therein will thereafter be exempted. Learned counsel for the assessee argues that "to assess to income-tax" means "to calculate the income-tax payable by the assessee". I am unable to accept this contention. It seems

to me that the only meaning which the words can bear is "to ascertain or calculate the income tax payable". Since the firm at Calcutta suffered a loss, it was not assessed to income tax within the meaning of Sec. 14 (2) (b) and therefore the assessee is not entitled to exemption under that section. In my opinion the amount of Rs. 51,180 was correctly treated as the assessee's share in the Calcutta firm for the assessment year in dispute and it was not exempt from income tax under Sec. 14 (2) (b).

BAJPAI, J.—I agree. I wish to add a few words generally on the three questions referred to us. The entire scheme of the Indian Income tax Act and more particularly Sec. 64 shows that the question of jurisdiction should be raised by the assessee before the Income tax Officer and not at a later stage.

On the other two questions it is enough to say that the entire income which a firm makes is assessable to tax even if out of it a portion is allocated as profits to the various partners in the firm as interest, and the partners would be entitled to exemption on the amount of the said profits, if it has been assessed to income tax in the hands of the firm, under Sec. 14 (2) (b), but the firm itself is not entitled to say that the amount of profits in its hands should not be treated as income; the firm can claim an allowance on the amount of interest paid only in respect of capital borrowed for the purposes of the business where the payment of interest thereon is not in any way dependent on the earning of profits under Sec. 10 (2) (iii) but in the present case the payment of interest to partners is only in the nature of allocation of profits and not because of any borrowed capital. However, the question of the liability of the the firm to income tax is not before us, and the only question is whether the amount of Rs. 51,180 had been correctly treated as the assessee's share in the Calcutta firm for the assessment year in dispute and learned counsel for the assessee has not been able to show any mistake of the Department in the calculations made except to argue generally that there has been double taxation of the same income, once in the hands of the firm and a second time in the hands of the assessee who is a partner of the firm. The answer to this lies in the fact that although the entire profits made by the firm were taken into consideration (without making allowance for the amount of interest paid to the various partners) in order to determine the income of the firm, the firm was not assessed to any income tax because of certain losses which absorbed the entire income and left the firm with a net loss instead of profit. The income made by the assessee on the head of interest received

from the firm can be exempted under Sec. 14 (2) (b) only if the firm had made certain profits and those profits *had been assessed to income tax.* Profits can be said to be assessed to income tax only when an order has been made by the Department determining the sum payable by an assessee as income tax and not when calculation only of the profits and losses have been made. There is in the present case, therefore, no double taxation, and the amount of Rs. 51,180 has been correctly treated as the assessee's share in the Calcutta firm for the assessment year in dispute, and the amount was not exempt from income tax in view of the provisions of Sec. 14 (2) (b).

Per Curiam.—The answer to question (a) referred to us is that the assessee was not competent to ask the Commissioner of Income tax to state a case on the question of jurisdiction.

The answer to question (b) is in the affirmative, and the answer to question (c) is in the negative.

Let a copy of our Judgment be sent to the Commissioner of Income tax under the seal of the Court and the signature of the Registrar.

The assessee will have to pay the costs of this reference which will be certified by the Counsel for the Department. We allow a month to Mr. Kamala Kant Verma to file a certificate. We record the fact that the case was heard for over three days and Mr. Varma argued it with ability.

END OF VOLUME V.

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